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On the cover
The best approach to the host of this weekend's G8 summit is wary engagement: leader

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Politics this week

Jul 13th 2006
From The Economist print edition

AFP

Israel's conflict with **Palestinian** militants in Gaza spread to **Lebanon** after the Lebanese Hizbullah party attacked an Israeli patrol on Israel's northern border, captured two soldiers and killed five more. In response, Israel bombed Beirut airport, blew up bridges and imposed an air and sea blockade on Lebanon. On the same day as the Hizbullah attack, Israel killed nine members of one family in an air strike that destroyed a house in Gaza where senior Hamas militants were said to be meeting. The Gaza militants continued to hold an Israeli corporal captured a fortnight ago. See article

Sectarian violence in **Iraq** reached new depths when gunmen reportedly loyal to a firebrand Shia clergyman, Muqtada al-Sadr, killed some 40 Sunni civilians in a Baghdad district on July 9th purely because of their religious affiliation. Scores of civilians were killed in other sectarian atrocities. The prime minister, Nuri al-Maliki, told Iraqis they had a “last chance” for peace if they pursued his recent reconciliation initiative; as a token of his intent, Iraqi soldiers fought several battles with Shia militias suspected of sectarian killings. See article

Russia and China agreed to resume discussions at the UN Security Council on **Iran's** nuclear defiance after it refused to respond until late August to an offer of incentives put together by America and the Europeans if it suspended uranium enrichment. A new resolution is expected, with sanctions to be discussed at a later date.

Somali Islamists crushed the last pockets of opposition from warlords in **Somalia's** capital, Mogadishu, while the internationally recognised but feeble transitional government, in the western town of Baidoa, was said to have asked neighbouring Ethiopia to help prop it up. See article

The start of peace talks in the southern Sudanese capital, Juba, between the **Ugandan** government and the rebel Lord's Resistance Army, which has ravaged northern Uganda for two decades, was delayed; no one knew for how long.

Savagery unbound

Reuters

A series of seven bombs exploded on **Mumbai's** railway network, killing close to 200 people and injuring more than 700. Though many people suspected Pakistan-linked Kashmiri separatist groups (no one claimed responsibility), the Indian government declined to point a finger at its neighbour. About 350 people were detained by the police for questioning. See article

A week after **North Korea** test-fired seven missiles, the UN Security Council was still debating what steps to take. Japan and America are pushing for sanctions, while China and Russia are opposing them. See article

Counts and courts

Mexico's electoral authorities confirmed the results of July 2nd's presidential election. Felipe Calderón, the centre-right candidate, won with 35.89% of the vote. But Andrés Manuel López Obrador, who trailed by only 0.58%, or 244,000 votes, is challenging the results in court. A final resolution is unlikely to come before September. See article

Genocide charges against Luis Echeverria, Mexico's president from 1970 to 1976, were dropped after a

court ruled that the case fell outside the statute of limitations. The charges related to the killing by government troops of up to 300 student protesters in **Mexico City** in 1968, when Mr Echeverria was interior minister. Hundreds more Mexicans died or disappeared during the “dirty war” against leftists under his presidency.

A month before Fidel Castro turns 80, the White House approved a transition plan for **Cuba** with an eye to his eventual demise. It is intended to increase support for democracy on the island.

Oh do try and keep up

In a change to its previous stance, the Bush administration accepted that prisoners held at **Guantánamo Bay** have rights under international law. A Pentagon memo, written after the Supreme Court's recent ruling on the matter, conceded that all military detainees held by the United States are subject to the Geneva Conventions. See article

The House of Representatives passed a bill restricting the ability of Americans to **gamble** online. Critics argued that the measure would be hard to enforce if it eventually became law, as most online gaming businesses are based outside the United States.

Colorado's legislature, in a special session, approved 11 measures aimed at curbing illegal immigration, including the withholding of non-emergency state services. With Congress divided, the legislation is the latest to come from states that are pressing ahead with the issue. See article

Gotcha

Russia's most wanted Chechen terrorist, Shamil Basayev, who masterminded the Beslan school siege in September 2004, was killed in Ingushetia. The Russians claimed they did it; Chechen rebels said it was an accident. See article

Lord Levy, **Tony Blair's** chief fundraiser, was arrested as part of a police investigation into whether people who lent money to the Labour Party were promised seats in the House of Lords. He was released on bail and has not been charged, but the affair could damage the prime minister and hasten his departure. See article

Poland acquired a new prime minister: Jaroslaw Kaczynksi, leader of the Law and Justice party and twin brother of the president, Lech. The party had suggested that it would be odd to have twins in the top jobs; but the previous prime minister, Kazimierz Marcinkiewicz, quit partly because of interference by the two brothers. See article

The orange coalition collapsed again in **Ukraine**, even before its would-be prime minister, Yulia Tymoshenko, was sworn in. Her rival, Viktor Yanukovich, who lost the 2004 presidential election to Viktor Yushchenko, may now become prime minister. But amid the fisticuffs in the Ukrainian parliament, nothing is certain. See article

EPA

Italy won the football World Cup in Berlin after a penalty shoot-out against France. Joy in Rome, gloom in Paris—especially as the French captain and hero, Zinédine Zidane, was sent off for head-butting an opponent in the chest. See article

Holidays in orbit came a step closer with the launch of Genesis 1, an experimental **inflatable spacecraft**. The craft, paid for by Robert Bigelow, an American hotelier, took off from Siberia on a converted ballistic missile. If the test is successful, it will pave the way for cheap, habitable structures in space.

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Business this week

Jul 13th 2006
From The Economist print edition

The European Commission handed down another big fine to **Microsoft**. The commission said it was charging the software company *euro*280.5m ($357m) for failing to comply with a 2004 antitrust ruling requiring it to share information that enables rivals' applications to run on Windows operating systems. Microsoft said it would appeal against the latest fine.

Plans to reduce the cost of **mobile-phone calls** between European countries were also unveiled by the European Commission. “Roaming” charges have attracted the ire of business and consumer groups. In the face of intense opposition from mobile companies (which make up to 15% of their profits from roaming), the commission proposed retail and wholesale price caps, to lower charges. See article

The 2004 merger that created **Sony BMG** was thrown into confusion as a European court threw out the deal. The case was brought by smaller music companies claiming the merger hurt competition, but the ruling also cast doubt on recent merger soundings between EMI and Warner Music.

Lucent's share price fell after it issued a profit warning on the back of weak sales. The share price of **Alcatel** also dropped as investors speculated that this would scupper the pair's agreement to create one of the world's biggest makers of networking equipment.

A way out for Li

Richard Li, **PCCW**'s chairman and biggest shareholder, agreed to sell a stake of 23% in the Hong Kong telecoms firm to Francis Leung, a local financier, for HK$9.2 billion ($1.2 billion). In an unusual deal, Mr Li is allowing Mr Leung to pay 70% of the total price later, but his decision should avert an incipient bidding war that brought rumblings from Beijing about foreigners buying up strategic communications assets. TPG-Newbridge, a private-equity firm, and Australia's Macquarie Bank were said to have offered over $7 billion for PCCW's core assets. See article

Real-estate investment trusts that specialise in shopping malls were swept up in two deals. **Kimco Realty** bought **Pan Pacific Retail Properties** for $2.9 billion. And Australia's **Centro Properties** continued its spending spree in America by acquiring **Heritage Property Investment Trust**, which Centro valued at $3.2 billion.

Kraft Foods agreed to buy the Spanish and Portuguese operations of Britain's **United Biscuits**. The deal should boost Kraft's international presence ahead of its expected spin-off by its parent company, **Altria Group**. That demerger came closer last week when Florida's top court broadly sided with Altria and other tobacco companies in rejecting a $145 billion award made to smokers in 2000.

Flying low

Beset by management and production problems, **Airbus's** summer of woes continued when it reported that aircraft orders had fallen by more than half in the first six months of 2006 compared with a year earlier. Airbus took 117 orders; **Boeing** took 480, an increase. However, some analysts said Airbus still has a chance of pulling ahead of Boeing in sales (again) by the end of the year. Both companies are expected to announce more orders at next week's Farnborough air show.

Eurotunnel asked a French court to protect it against creditors after talks broke down with a group of bondholders that are disgruntled with the company's debt restructuring plan. The operator of the tunnel that links Britain with France singled out Deutsche Bank, which is leading the dissident group, for criticism.

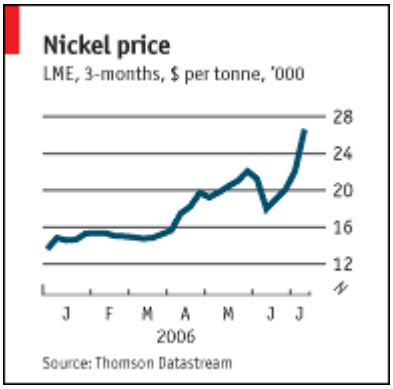
One of Britain's biggest insurers, **Aviva**, expanded its American operations by agreeing to buy **AmerUs**, a life-insurance firm based in Iowa, for $2.9 billion.

Banks in Russia extended their opening hours to cope with a surge of last-minute investors hoping to get a slice of **Rosneft's** public offering. The state oil firm's flotation is attracting a lot of interest, not least from international oil companies hoping to acquire strategic stakes.

The takeover battle intensified for **Falconbridge**, a Canadian miner of nickel and copper, when **Xstrata**, a Swiss-based mining group, raised its bid in an effort to entice Falconbridge's shareholders away from a merger deal with Falconbridge's compatriot, **Inco**. The Inco-Falconbridge combination is itself the target of a takeover by **Phelps Dodge**, an Arizonan copper miner.

Going mental for metal

Underlining the metal industry's desire to consolidate, the **price of nickel** reached a record high for delivery in three months. With stockpiles of the metal falling to a reported two days' supply in some warehouses, nickel's scarcity is one factor that has led to its price almost doubling since the beginning of the year.



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The G8 summit

Living with a strong Russia

Jul 13th 2006
From The Economist print edition

The best approach to the host of this weekend's G8 summit is wary engagement

FORGET the formal agenda at this weekend's G8 summit, given over to energy security, infectious diseases and education. The really awkward issue for the leaders of the seven rich democracies gathering in St Petersburg concerns their host: how to live with a strong, but increasingly undemocratic, Russia.

Since Vladimir Putin became president in 2000, Russia has in many ways been a remarkable success. Thanks largely to high oil prices, its economy has grown by an average of 6.5% a year. Living standards have improved and a sizeable middle class has emerged. The stockmarket has boomed. Russia is running a huge current-account surplus, it is paying off the last of its debt and the rouble has just been made fully convertible. At the summit Russia also hopes to surmount the last hurdles to its joining the World Trade Organisation.

Russians are grateful for these things. They like the stability that Mr Putin has brought in place of the chaos under his predecessor, Boris Yeltsin. They welcome their country's bounceback from the dark days of August 1998, when it defaulted and devalued. They are proud that, as the summit demonstrates, Russia once more counts for something in the world. No wonder Mr Putin has a popularity rating in the 70% range—an achievement that none of his guests can match.

Yet as well as these steps forward Russia has taken steps backwards (see article). In Mr Putin's early years optimists hoped that stability and prosperity would not come at the expense of liberty and democracy. Western leaders gave him the benefit of their doubts over such matters as the war in Chechnya or curbs on the media. But it has become ever clearer that Russia is moving in the wrong direction. Greater state control of the economy, especially in the energy industry, has bred corruption and inefficiency. Any serious political opposition has been crushed. The broadcast media have been shut down or taken over by the government and its allies. Regional governors have been squashed—one of the last elected governors was arrested recently—and parliament has been emasculated, continuing the Kremlin's drive not merely to centralise, but to monopolise, political power.

Those were the days

There is much debate over when Mr Putin started to go wrong. Many date it to the attack on Yukos, Mikhail Khodorkovsky's oil firm, that began three years ago this month; others say the clampdown started after the Beslan school siege in September 2004; still others point to the “orange revolution” in

Ukraine at the end of 2004, when Russia's choice for president, Viktor Yanukovich, lost to the pro-Western Viktor Yushchenko. In an irony of timing, only days before the summit, the Chechen terrorist who was responsible for Beslan, Shamil Basayev, was killed (see obituary); and Mr Yanukovich re-emerged as a possible prime minister of Ukraine (see article).

Yet the truth is that there was no particular moment when Mr Putin “started to go wrong”. Even Kremlin insiders admit that he was determined from the outset to control the television channels and to stamp out political opposition. They concede that Mr Khodorkovsky is in prison for political reasons. Such things reflect Mr Putin's background as a KGB officer. To him, restoring order, staying in charge and reviving Russia's influence are what matter—not wishy-washy worries over democracy and human rights.

What to say to Putin

So what can the West do? The short answer is, not a lot. In the 1990s an economically enfeebled Russia needed help from abroad. Unless the oil price unexpectedly collapses, no such leverage will be available in the near future. Politically, too, pressure from outside is likely to rebound. With the Kremlin once again firmly in control, Russia will almost certainly change only from within—or not at all.

This is not to say that the West has no influence. Mr Putin, like other Russian leaders before him, is sensitive to outside criticism. The Kremlin was this week in high dudgeon because senior Western officials attended a conference in Moscow organised by some of Mr Putin's few remaining opponents. The Russians are also neurotically keen to curtail the activities of non-governmental organisations.

Here lie some clues to what Western leaders should and should not do about Russia. They should speak out against Mr Putin's moves away from democracy, against his policy in Chechnya, or against Russian use of energy to bully its neighbours (many west European countries have been too timid in their criticism). They should continue to help NGOs and others who are trying to establish a civil society that may, one day, provide an alternative to the dead weight of the Kremlin. As the next presidential election of March 2008 nears, they should insist that any move to amend the constitution so that Mr Putin can run again is unacceptable—and would result in Russia's expulsion from the G8. They should do what they can to press for free and fair elections, even if the Kremlin's chosen candidate seems sure to win.

There are things they should not do, as well. Russia's membership of the G8 may be an embarrassment, since it is supposedly a club of democracies. But to throw it out now would only push Russia farther out of the West's orbit, and risk making it even less helpful over such issues as curbing Iran's nuclear ambitions. Equally, Americans and Europeans are right to assist countries in Russia's near-abroad that want to escape its baleful influence. But to push for Ukraine or Georgia, say, to join NATO before they are ready would serve no good purpose. Above all, Western leaders should avoid giving the impression that what they really object to is not an illiberal and undemocratic Russia but a strong and rich one—a paranoia that even Russia's few remaining liberals all too often share.

Sixty years ago a wise American diplomat, George Kennan, proposed that the right policy of the West towards an expansionary Soviet Union under Joseph Stalin should be “containment”. Russia today is clearly no such threat. But it still matters, and the West should care about where it is going. The best policy now is no longer containment but “wary engagement”.

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Bombs in Mumbai

India's horror

Jul 13th 2006
From The Economist print edition

The attacks in Mumbai show why India and Pakistan must solve the problem of Kashmir

MADRID, London and now Mumbai: a hideous new evil stalks the world's great cities. In the cramped confines of a packed commuter train at rush-hour, a small bomb in an innocent-looking bag will cause carnage. A batch of them, timed to go off near-simultaneously and secreted on a series of trains, will cause devastation, overwhelming security services, wrecking vital infrastructure and creating widespread panic, all at minimal effort and expense to the terrorists. So it was in Mumbai on the evening of July 11th, when a series of seven explosions on trains and at two stations killed close to 200 people, and wounded 700 more (see article).

It is hard to think of a more cowardly and evil form of attack than this. Yet one positive thing has emerged. The first instinct of India's prime minister, Manmohan Singh, was to call for calm and restraint, rather than to point an accusatory finger at Pakistan for sheltering the *jihadi* groups who, by common reckoning, are the most likely people to have perpetrated the outrage. By contrast, when terrorists attempted to blow up India's parliament building in Delhi in December 2001, the then government, led by the Hindu nationalist Bharatiya Janata Party, mobilised for all-out war against Pakistan, sending hundreds of thousands of troops to the border. Pakistan responded in kind. Since both countries had tested nuclear weapons only three years earlier, the confrontation, which dragged on for months, was, to put it mildly, an alarming one.

Mr Singh has devoted plenty of effort during his prime ministership to trying to improve relations with Pakistan, and to moving the endless argument between the two countries over the disputed state of Kashmir forward a little. He is not, it seems, about to allow a few mass-murderers to destroy all that. Nor is Pakistan's president. General Pervez Musharraf was swift and unequivocal in his condemnation of the horror.

How India sees the general

Both men may need to be still more resolute in the near future. On the assumption that Pakistan-linked groups remain the prime suspects (as they usually are when bombs go off in India), the danger is that India will eventually again lose patience with Pakistan's president-general. Broadly speaking, there are two views in India of General Musharraf. One is that he is in essence a man of peace, trying hard to make a deal with India over Kashmir and to rein in the militants who stalk his land and who have sympathisers in the upper echelons of his army and its powerful Inter-Services Intelligence outfit, the

ISI. On this view, the general is doing about as much as he can, given the constraints under which he operates—graphically illustrated by the periodic assassination attempts that have come close to killing him.

There is another, darker view, however. Many influential Indians have never trusted General Musharraf, who, when he was just a soldier, launched a border war against their country in 1999. They say his efforts to root out terror outfits like Jaish-e-Mohammad and Lashkar-e-Taiba (which this week were widely blamed for the Mumbai bombs) have been cosmetic and half-hearted; that his attempts to reform the ISI have been partial; that he talks peace out of one side of his mouth while quietly allowing the ISI to use the terror groups to keep up the pressure on India. Even if he is not guilty of bad faith, they say, he is too weak to be of much use as a partner.

Historians can argue about which of these caricatures most accurately suits the general (there is probably truth in both of them). What matters is that every time innocent Indians die, attitudes in India towards Pakistan harden—and that is in nobody's interests. For General Musharraf, the message should be clear: either he must find a way to deal with the *jihadis* that his own security apparatus has nurtured on Pakistani soil, or all his efforts to repair his country's image will come to nothing. But the burden must not fall only on the general. India, too, could do much more to make things easier for Pakistan's tightrope-walker-in-chief to face down the terrorists.

The things India needs to do too

Nothing can ever excuse acts of terror like those that have taken place this week in Mumbai, and, once again, nobody has yet proved a link to Islamic extremists. However, a just settlement in Kashmir would do more to undercut the men of blood than any amount of Pakistani police-work. Time and again, General Musharraf has offered constructive proposals for resolving the row over Kashmir, which has bedevilled the subcontinent for 59 years and led to two full-scale wars and any number of near-misses. But India, for all Mr Singh's efforts, has consistently dragged its feet, offering talks and more talks, but always ruling out anything that would involve giving up any of its territory or any of its sovereignty in Kashmir.

India negotiates from a position of strength: it holds by far the richer part of Kashmir, and whatever solution it envisages will not change that. But bus links across the line of control (that divides Indian- from Pakistani-held Kashmir), and the offer of more autonomy for the Indian bit, will never be enough to satisfy even the peaceful Kashmiri separatists under Indian rule, let alone the murderous *jihadis* with links to Pakistan. General Musharraf might be willing to settle for the crumbs that India is offering, but the murderers will do everything they can to stop him. It is not appeasing terror to say that India needs to do more to find a solution in Kashmir; so far India has not put enough on the table for a fair deal to be possible.

India hopes to be a great power. By dint of raising its economic growth rate from 6% to 8% a year, it has attracted vast attention. This week's atrocity in its economic capital should not undermine its progress. Mumbai has always been a chaotic city: witness its authorities' utter inability to cope with monsoon flooding last year. But the bombings serve as a reminder that India, despite all the hype, is not a country wholly at peace. Until it is fully reconciled to Pakistan, and until Pakistan has wrestled its own particular demons to the ground, India will never achieve its full potential, either economically or geopolitically. And neither of those two things can happen without a durable solution in Kashmir.

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Mobile phones

Done roamin'

Jul 13th 2006
From The Economist print edition

Rules for international charges for mobile phones make sense; being heavy-handed does not

Landov

"€€€€€€€€K!" Use your mobile phone while travelling across Europe, and that may well be the reaction when you get your bill. Although fierce competition has driven down the cost of mobile calls within national borders to a few cents a minute, the cost of using a mobile phone abroad is still sky-high. A Briton in Slovenia may pay nearly €2 ($2.55) a minute to call home and almost as much to receive calls.

National regulators cannot help much. Forcing mobile operators to reduce what they charge foreign operators whose customers roam onto their networks (the wholesale price) does not guarantee that those foreign operators will pass on any of the reduction to their customers (the retail price). Enforced cuts in a country's wholesale prices serve only to put its operators at a disadvantage to their foreign rivals. Naturally, regulators stay their hands and roaming prices stay high.

So Viviane Reding, the European Union's commissioner responsible for telecoms, is right to step in. Yet, although the ends are laudable, her means are questionable. What Ms Reding proposed this week—applying caps not just to wholesale prices, but to retail prices too—could itself have undesirable consequences (see article). Rigid caps on retail prices will limit operators' ability to offer novel roaming schemes. For example, the Passport option offered by Vodafone, Europe's biggest mobile operator, which allows subscribers to pay a fixed roaming charge of around €1 per call plus whatever they would normally pay at home, may fall foul of the new rules. Price caps can also discourage investment and innovation. Why adopt a new, cheaper technology if you cannot increase your margins? And caps on roaming charges will cause operators to raise prices elsewhere.

There is more than a dash of populism behind Ms Reding's attack on the industry. The campaign against roaming charges has attracted more public support than any European policy in living memory—its backers include even the *Daily Mail*, a British newspaper not famed for its love of the EU. Although the commission may like the idea of providing citizens with proof of the merits of EU membership in the form of lower call charges, that hardly makes for wise policy.

But the main reason why a heavy-handed approach is unnecessary is that prices are finally coming down, as operators introduce new pricing schemes such as Passport. (Indeed, for many years European regulators prevented Vodafone from cutting its roaming prices on antitrust grounds.) Last month an alliance of operators, representing 70% of European mobile users, said they would cut their wholesale roaming prices by half. Having kept quiet about their roaming charges for years, some operators are starting to boast about their low roaming rates instead. And both the commission and the industry have launched websites to help travellers find the operator with the lowest rates in each country—thus putting pressure on rivals to cut their prices.

Reding room

Of course, such price cuts and transparency have been prompted in large part by the threat of

regulation. The plans announced this week, which provide for a six-month delay after the imposition of wholesale-price caps before retail-price caps kick in, could yet be watered down. It would be best to avoid retail-price regulation altogether. The broad trend in telecoms regulation is towards a lighter, less interventionist touch, as Ms Reding's recent proposal for a new European regulatory framework acknowledges. Roaming is a special case; regulators would be wrong to conclude that it paves the way for similar intervention in other areas of the industry.

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Somalia

Courting trouble

Jul 13th 2006
From The Economist print edition

The comparison with the Taliban is overdone, but America needs to push for peace now

Get article background

AT FIRST sight, recent events in Somalia look depressingly similar to those in Afghanistan when it fell to the Taliban. After 15 years of civil war and no government, an Islamist army has swept aside warlords and firmly asserted its control. This week the Council of Islamic Courts (CIC) finally took the entire capital, Mogadishu, and it controls several towns nearby (see article). As in Afghanistan, exhausted people are finding mullah-rule better than anarchy and extortion; as roadblocks have been lifted, prices have fallen. But outsiders, especially America, fear that the CIC is a shield for al-Qaeda.

Somalia is actually very different from Afghanistan. For instance, it is ethnically homogenous. Its divisions, ever since it fractured in 1991, have mainly been between clans—or, as it has continued to fall apart, between sub-sub-sub-clans. Unlike the Taliban, which was dominated by a single Pushtun tribe, keen to assert its rights over other ethnic groups, the CIC is creaking with inter-communal tensions. Indeed, those divisions are suggested by its name. Although Islamic courts have for several years been the only dispensers of justice in Mogadishu, each one is controlled by a distinct sub-clan—and cannot try a member of a rival group. If previous feuds are anything to go by, family ties will prove stronger than Islamist unity.

The CIC offers an opportunity as well as a threat. Although its leaders want to build an Islamist state, some of them seem to realise that this would be unacceptable to many Somalis, who are a fairly secular lot. The CIC's most pressing concern is to prevent foreign peacekeepers, from Uganda and Sudan, being deployed to Somalia under the terms of a regional peace plan. This was designed to shore up the 14th effort to make a government in Somalia. The government—a coalition of warlords and businessmen recognised by the United Nations but by only a minority of Somalis—is cowering in the town of Baidoa, under a surreptitious guard of Ethiopian troops.

If the government and the CIC could negotiate a power-sharing deal, Somalia might end up with a government that actually controls its terrain. If the two sides fight, the consequences could be dreadful. Ethiopia would be likely to send more troops to the government, rallying many nationalists to the CIC and boosting hardliners among the Islamists, such as their joint leader, Sheikh Hassan Dahir Aweys, who is accused by America of helping a few al-Qaeda fugitives in Somalia.

If that worries America, it has itself partly to blame. Early this year, it gave cash and guns to certain warlords in Mogadishu to grab the fugitives and their local friends on its behalf. This helped spark the recent conflict, in which several hundred people have been killed, and the CIC has triumphed.

With the European Union, America should urge Somalia's factions to negotiate. They should also insist that Ethiopia, a hated neighbour, withdraw its troops. And they should help uphold a UN arms embargo on the country. A governed Somalia would be easier to police—which is why America should quit meddling on the cheap, and pursue serious diplomacy.

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Extradition and the NatWest Three

Unintended consequences

Jul 13th 2006
From The Economist print edition

Reciprocity is not the issue; safeguarding the right to a fair trial is

Rex Features

THEY weren't dragged away in leg-irons, but the dispatch by air on July 13th of three British bankers to America to stand trial was as dramatic as legal spectacles get. David Bermingham, Gary Mulgrew and Giles Darby—the so-called NatWest Three—are charged with helping to pull off a £11m ($20m) fraud linked to the collapsed energy giant, Enron. The suspects are British; their victim is British; virtually all the alleged wrongful dealing was carried out in Britain. Their trial, however, like that of Enron's executives, will be in Houston.

Outrage over their plight, and the flawed fast-track bilateral extradition treaty that produced it, has united left and right, law lords and NGOs, businessmen and civil-liberties activists (see article). But what, exactly, is at issue?

Most of the fuss has been about reciprocity—or the lack of it. The three were handed over under the terms of a treaty signed by Britain and America in March 2003 and broadly enshrined in Britain's omnibus Extradition Act later that year. The treaty and the act reduced the supporting material that America must provide in requesting extradition from Britain. But America (which had a lousy record of surrendering Irish terrorists to Britain) has yet to ratify the treaty.

Under the old rules America had to present “prima facie” evidence of guilt on the basis of which a jury, in the absence of a defence, could have convicted somebody. That burden of proof was rather higher than the “probable cause” that Britain had to show when requesting extradition from America. Now, although both countries have to produce factual information when they request extradition, only Britain has also to provide assessable evidence that there is a “reasonable basis to believe” a crime was committed and an identified person did it.

British ministers maintain that the burdens of proof are now roughly equivalent. Few expert lawyers on either side of the Atlantic agree. And there is another imbalance over who controls the gateway. American courts decide whether there is sufficient evidence before requesting extradition from Britain; and America again decides whether the evidence submitted by Britain in support of a British request for extradition is sufficient to justify compliance with it. The perceived unfairness of this asymmetry is linked to yet another grievance: although America has yet to ratify the treaty, it is indirectly benefiting from its looser evidentiary requirements.

In fact, both ratification and reciprocity are red herrings. Even if the Senate were to yield to Britain's pleadings and ratify the treaty tomorrow, it would not affect either the relative burdens of evidence or the fate of the NatWest Three. As for the lack of reciprocity embedded in the treaty itself, Britain has never insisted on exact parity when extraditing its citizens, nor is exact parity always possible. If justice can best be served elsewhere, so be it. The law is not a “zero-sum” game.

In friendship we trust

That does not mean that any government—in this case Britain's—should outsource the job of determining whether a citizen should stand trial, especially in a foreign country where he is likely to be at a disadvantage and particularly when the alleged offence was committed at home. America's bill of rights protects its people from search and seizure without demonstration of probable cause; Britain should do no less. It is a fundamental duty of governments ancient and modern to provide their citizens with due process and a fair trial.

Sadly, Britain's government has already sold this pass, and not only to America. The treaty is part of a worldwide network of extradition arrangements, tightened to combat globalised crime and terrorism. In pursuit of these laudable goals, Britain has agreed, among other things, to extradition without prima facie evidence among 44 signatories of the Council of Europe's Convention on Extradition. America, with three Commonwealth countries, is now included in the list.

This was to compound one mistake with another. It is a principle of British law that the prosecution has to establish a case or see it chucked out. By agreeing to extradite without proper evidence—to America or to Azerbaijan—Britain has surrendered a safeguard on which its citizens have every right to rely. That is the real tragedy of the NatWest Three.

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On philanthropy, American expatriates, Haiti, department stores, seeds, political fashions

Jul 13th 2006
From The Economist print edition

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Charity begins at home

SIR – In praising Warren Buffett, Bill Gates and others for their philanthropy, you endorse the view that capitalism's winners should "use some of their wealth to compensate the losers" ("Billanthropy", July 1st). Innovators like Mr Gates make money by serving their customers, who also gain from the exchange. The idea that wealth creators have a duty to "give back" betrays a lack of understanding of that most basic principle of economics: voluntary trade benefits both parties. Whether the wealthy should help the poor is an important ethical question, but to confuse charity with compensation is just bad economics.

Isaac DiIanni
Fairfax, Virginia

SIR – I was disappointed to read that Mr Buffett would be leaving the bulk of his entire fortune to the Gates Foundation, with the balance going to foundations controlled by his children. This is the same Mr Buffett who has very publicly advocated the retention of the estate tax to prevent intergenerational transfers of wealth. Current estate-tax rates would ensure that Mr Buffett's estate would generate around $17 billion for the treasury (were he to die this year), which he will now avoid. Is this, perhaps, a classic case of "Do as I say, not as I do"?

David Zisser
San Francisco

SIR – I would be the last person to argue against investing research dollars where they can do the most good ("How to spend it", July 1st). But in the case of diabetes the statistics you used underestimate—by multiples—the mortality and disability burden of the diabetes epidemic (350m sufferers by 2025, 80% of them in developing countries). Most of your data is based, originally, on World Health Organisation statistics, which came from death certificates. Rather than coding diabetes as the cause of death, 89% of doctors code the end-stage complications of diabetes. These include heart disease and stroke, renal failure and opportunistic infections. More recent work from the WHO gives diabetes mortality numbers that are 3.5 times higher.

The investments that the Gates Foundation and others are directing towards infectious and parasitic diseases like malaria are wonderful and long overdue. Perhaps now they can also address diabetes and cardiovascular disease, which impose an equal burden in the regions they are trying to help.

Jonathan Betz Brown
Chair, Task Force on Diabetes Economics, International Diabetes Federation
Portland, Oregon

SIR – It is not true that "the Gates Foundation will eventually be able to count on assets of around $60 billion", at least not as a result of Mr Buffett's generosity ("The new powers in giving", July 1st). One of the conditions Mr Buffett put on his annual gifts is that "beginning in calendar 2009, [the Gates Foundation's] annual giving must be at least equal to the value of my previous year's gift plus 5% of [the Foundation's] net assets."

That condition has important income-tax benefits for Mr Buffett, and it guarantees that his annual donations will be promptly distributed rather than accumulate. Annual spending will go up from (approximately) $1.5 billion to $3.5 billion, but the Foundation's assets will not increase to $60 billion because of Mr Buffett's munificence.

Harvey Dale
Director, National Centre on Philanthropy and the Law
New York University School of Law
New York

Employment opportunities

SIR – I agree that the change to tax rules for American expatriates is counterproductive ("The tithes that bind", June 24th). Americans who work abroad do more than just generate money. They also boost America's "soft power" by contributing to a better understanding in their host countries of Americans and their values. Indeed, Americans working in other countries provide cheap public diplomacy for America. Congress should eliminate, not raise, taxes on expatriates and encourage more Americans to work abroad as the best way to alleviate stereotypes and break down cultural barriers.

Donald Osterlund
Beijing

Work fair?

SIR – I was somewhat taken aback in your support for rural job programmes as a model upon which to rebuild Haiti's infrastructure ("An uphill struggle", June 24th). "Make work" schemes have been a dismal failure in Haiti. They are neither transparent nor accountable; in most cases local leaders, who receive funding to employ workers, select people who are personally connected to them and expect kickbacks from the workers in return. But the worst aspect of the programmes is that they have completely undermined the cultural tradition whereby people living in the countryside would volunteer for community-based projects, such as cleaning canals. Now, most Haitians won't pick up a single piece of paper unless they are getting paid.

David Doherty
Camp Perrin, Haiti

A retail tale

SIR – Your report on internet advertising claimed that John Wanamaker invented the department store and price tagging in the 1870s ("The ultimate marketing machine", July 8th). Accustomed as one is to ideas originating in America and spreading to the rest of the world, it seems that the French can probably lay claim to creating both the first department store and price tags. Aristide and Marguerite Boucicaut founded a large drapery and dry-goods outlet in Paris, Le Bon Marché, in 1852. Starting in 1869 the store launched the novel idea of displaying its wares for customers to inspect with price tags attached. Wanamaker entered the menswear business in 1861 and probably introduced price tags in 1874, around the time he commenced his innovative (ie, truthful) advertising.

Jon Manning
Sans Prix Strategic Pricing Consulting
Ascot Vale, Australia

Location, location, location

SIR – I find the concept behind the Svalbard International Seed Vault a good one in theory ("Seeds of hope", June 24th). But I'm a little curious as to how the last survivors of a nuclear war are going to manage to get to the remote Arctic island that houses the vault, traverse the frozen glacier, avoid polar bears, descend 70 metres underground and prise open the "strong" security door to get at the precious seeds? I guess at that point I won't be around to find out.

Josh Kritzler
Manhattan Beach, California

Fashionistas

SIR – Thank you for letting us know that Hillary Clinton was “decked out in an orange trouser-suit” during a recent conference (Lexington, June 17th). I am using this information in conjunction with economic policy I have gleaned from various fashion magazines to make up my mind about her candidacy. Perhaps in the future you could report if Al Gore's tie matched his trousers and if George Bush wore shorts on a hot day.

Alexander Ferworn
Toronto

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Russia

Richer, bolder—and sliding back

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From The Economist print edition

AFP

The G8 leaders meeting in St Petersburg this weekend will find Vladimir Putin's Russia assertive, oil-fired and authoritarian

SHOES from Lobb's, the poshest boot-maker in London, were not available in Yekaterinburg until Igor Markin opened his shop last year. It sits on the edge of a park that once belonged to the tsars, not far from where the last of them was murdered. Because of its defence industries, Yekaterinburg was a closed city for much of the Soviet era. In the 1990s it was notorious, even by Russian standards, for its gangsters. These days, says Mr Markin, Yekaterinburg's highest-rollers often spend $50,000 or more in his store.

Admirers of President Vladimir Putin, who plays host to the G8 summit in St Petersburg this weekend, argue that the new wealth so conspicuous in Moscow has spread to other parts of Russia too. They are right. In Yekaterinburg, over 1,400km (nearly 900 miles) from the capital, others besides Mr Markin's clientele are prospering. Old buildings have been spruced up; restaurants, hotels and supermarkets are opening. So, soon, will the final adornment of any upwardly mobile city: an IKEA. The traffic jams may soon rival Moscow's. Most of the gangsters have died, fled, gone to jail or into politics. Local industry, now partly civilian, is sucking in workers from all over Russia. More and more people are visiting America and Europe. Compared with the 1990s, says Svetlana Garipova of the municipal government, it is “absolutely another country”.

For many Russians, life is indisputably better than in 1999, when, after a decade of coups, wars and economic catastrophe, Boris Yeltsin bequeathed the presidency to Mr Putin. Mr Putin can boast to his guests, in fact, that life for many of his countrymen is better than ever before in their nation's history.

This achievement rests partly on a virtue not previously associated with Russian governments: strict macroeconomic management. Mr Putin seems to regard foreign debt as a sort of national insult, and is paying most of it off. Inflation, at 9.1%, is high by Western standards but low by Russian ones. Alexei Kudrin, the finance minister, attributes the strong growth of recent years mainly to the new political stability brought about by Mr Putin.

But the success needs qualification. One blemish is that though a Russian middle class has begun to emerge, it is almost matched in size—about a quarter of the population, say some—by the number of Russians still living below the poverty line. All in all, as Mr Kudrin acknowledges, Russia is only just recovering the standard of living that it enjoyed in 1990.

An hour's drive from the neon of central Moscow are villages in which living conditions are primitive. An inconspicuous urban underclass lives in squalor. Russia still has more poor white people than any other country, though their number diminishes each year. No wonder: with male life expectancy below 59, the population shrinks by about 750,000 a year.

It should also be noted that Mr Putin has been lucky, indeed exceptionally so. As sceptics like to point out, his formidable popularity rating, in percentage points, almost matches the price of oil, in dollars per barrel (now about $74). Officials in Yekaterinburg say the city's prosperity does not depend on oil and gas, but they undoubtedly contribute to the local boom. So it is with Russia as a whole.

Russia still has more poor white people than any other country, though their number diminishes each year

But neither popularity nor petro-prosperity has strengthened Mr Putin's zeal for economic reform. Indeed, his early commitment has waned as the new money has gushed in, leaving Russia precariously dependent on the oil price. About $77 billion has been put aside into a rainy-day fund, but—much to Mr Kudrin's anxiety—the pressure to spend some of it is rising.

Another cause for concern is that Russia's growth has in some ways come despite, rather than because of, Mr Putin's policies. These have included the destruction of Yukos, once the country's foremost oil firm. Yukos's boss, Mikhail Khodorkovsky, incurred the Kremlin's wrath by, among other things, buying votes in parliament. He is now in a Siberian prison camp—“for political reasons”, according to Igor Shuvalov, a remarkably candid Kremlin aide. “Once you behead someone,” he says, “you give a good example [to Russia's other tycoons] of how to behave.” Those “oligarchs” not in prison or exile are indeed politically quiescent.

Foreign investors, spooked at first by Yukos's misfortune, have forgiven if not forgotten. But the damage has been lasting. In Russia, the episode affirmed, power still counts for more than the law. As in the days of the tsars, property is held only at the discretion of the Kremlin. (Weak property rights, and the state of the courts, says Mr Kudrin, are big economic problems.)

Another legacy of the affair is the state's growing role in the energy industry, partly through Gazprom, a state-run gas giant, and partly through Rosneft, the state oil firm that acquired Yukos's main asset via a rigged auction in 2004. Big companies in other industries, such as carmaking, have also been brought under state control. This trend, says Anatoly Chubais, the architect of Russia's 1990s privatisations, “will not bring any positive results for the Russian economy.” As one tycoon puts it, greater state control might not matter if the state were Norway; but in Russia, it means lower efficiency and output.

More rot, and fewer people to stop it

The campaign against Yukos encouraged—and may have been motivated by—a scourge that Mr Putin vowed to confront: corruption. The bandits may be quieter in places like Yekaterinburg, but the pay-offs they once extracted now accrue to corrupt bureaucrats instead. Hardened Russians generally divide officials into two categories: the utterly corrupt and the partially corrupt. The security services are rumoured to run all manner of criminal activities; the army is a cesspit of graft. Mystifying deals and decisions suggest that the money trail runs all the way to the Kremlin. Occasional anti-corruption purges and arrests look more like score-settling than genuine bids to clean the stables.

The biggest blots on Mr Putin's record, however, lie not in economic affairs but in other policies, especially those concerning civil and political freedom. Under Mr Putin, rising incomes have not been accompanied by the political liberalisation often thought to be prosperity's corollary. In the formulation of Grigory Yavlinsky, a now-marginalised liberal politician, Mr Yeltsin took mistaken steps in the right direction—towards democracy. Mr Putin has taken correct steps in the wrong direction—towards an authoritarian petro-state. The president's aides like to argue that, for every seemingly anti-democratic measure he introduces, analogies can be found in Western countries. What counts, however, is the overall picture. This is clear, and depressing: Russia today has little or no claim to be a democracy, not even the shabby, inadvertent kind of democracy it was becoming under Mr Yeltsin.

As well as suborning the justice system, the campaign against Yukos deterred Russia's businessmen from financing the Kremlin's political opponents. Anyone who might conceivably represent a political threat, however slight, is today likely to face court proceedings, tax inspections and, if he chooses to start an electoral campaign, an array of obstructions (meetings banned, electricity switched off, etc).

Both houses of parliament have been neutered, and new rules for political parties, and for elections, seem designed to keep them that way. United Russia, the only party that matters, has no ideology other than blind loyalty to the Kremlin. In some ways and places, it operates much like the old ruling party: to get certain jobs, it is said in Yekaterinburg, you need a party card. (“Whatever party we try to create,” an ex-prime minister of Russia once remarked, “we always end up with the Communist Party.”) Mr Putin has invented a new body, called the public chamber, to give people a say in politics, forgetting perhaps that parliament is meant to do that.

Non-governmental organisations that concern themselves with subjects such as human rights face harassment. After the recent introduction of onerous new obligations, they are likely to face more. And, apart from a few Moscow-based newspapers, the media are mostly supine.

The state, or Kremlin-friendly businesses, have taken over various television stations and other assets. Radio stations that broadcast American-financed programmes are the latest to be squeezed. Across much of Russia most people get their national news only from television, and Russian television's political coverage dwells largely on the president and his ministers and is almost entirely uncritical. In some regions, truly independent journalists suffer assault and murder. Elsewhere, they merely face unemployment.

Russia today has little or no claim to be a democracy, not even the shabby, inadvertent kind of democracy it was becoming under Mr Yeltsin

Mr Putin announced in 2004 that regional governors, hitherto elected, were instead to be appointed by him. The sleaze and criminality of many regional politicians made this seem almost sensible—until Mr Putin's appointments began. Now the arrangement is clear: in return for basic fealty, suitable election results and political calm, appointed governors may do largely as they please.

An extreme version of this contract applies to Chechnya, the most troublesome of all Russia's regions. The Kremlin has fought two bloody wars there, the second of which helped put Mr Putin in the Kremlin. The place is now run by Ramzan Kadyrov, an erratic 29-year-old rebel turned Chechen prime minister whom Mr Putin has taken to his heart—and with some success, it can be said.

Better news from Chechnya

The news this week of the death of Shamil Basayev, Russia's terrorist-in-chief (see article), will certainly put an extra spring in Mr Putin's step in St Petersburg. But even before Mr Basayev's demise, it was clear that life in Chechnya was improving. Reconstruction money may still be disappearing, but roads and buildings are being repaired. Though they still come under frequent attack, Russian troops no longer fight big battles with separatist guerrillas. Sergei Ivanov, Russia's defence minister, says many of the foreign mercenaries who once stiffened the resistance have decamped to Iraq. In Grozny, the capital, people can again go out at night.

But with Chechnya, too, there are shortcomings to set against the improvements. One is that Chechnya's stability rests on one man, Mr Kadyrov, and he could be a dubious prop. Mr Kadyrov has dabbled with Islamism, stands accused of horrific atrocities and is orchestrating his own cult of personality. Some say that skirmishes take place between federal troops and Mr Kadyrov's, though Mr Ivanov denies it.

The second difficulty is that the violence once concentrated in Chechnya is infecting the entire north Caucasus. Nalchik, the capital of Kabardino-Balkaria in the foothills of the Caucasus mountains, illustrates this deterioration. Its broad boulevards and lush parks seem peaceful, but the bullet holes are still visible on the government buildings attacked by about 150 armed men last October 13th.

One bloodbath, two stories

There are two versions of what happened that day. According to the relations of the 92 attackers who died, it was not an act of terrorism but an “armed revolt”. For years, they say, the locals had been detained, tortured and humiliated by the security services because of their interpretation of Islam. Mosques were closed, and jobs lost, until, as Valery Khatazhukov, a local activist, puts it, “Only weapons were left.” Afterwards, it is said, the police arrested anyone they fancied, guilty or not.

The other version, advanced by (among others) Mufti Anas Pshikhachev, the region's official Muslim leader, is that some of the insurgents were paid to take part, while others were advocates of a pan-Caucasian Islamic state who were in league with Mr Basayev. Some even say the fighters, who seemed to have little or no military training, expected Mr Basayev's forces to join them.

AFP

The end of the road for Basayev

Violence has flared elsewhere in the north Caucasus since October. In Ingushetia, where Mr Basayev was killed, shootings, explosions and even aerial bombardment have been almost incessant. Murders are frequent in Dagestan, in parts of which Islamic *sharia* law is enforced. All this, believe many locals, happens to a plan, designed to secure money or power for officials. More likely, no one is in control. As in Nalchik, events proceed from a murky but combustible mix: separatism, grudges, vendettas, territorial disputes, a history of war and mass deportation, and growing Islamic extremism. The problem, says the mufti, is that, after 70 years of Soviet atheism, religious ignorance has let extremism take hold. To all this can be added government brutality and pervasive corruption, which provides insurgents with weapons, lets them move round freely and, by strangling the local economy, guarantees a stream of recruits.

Mr Basayev's death may help. But probably the only real remedy is for local people to have a say in their own fates: in other words, democracy. Instead, as a prominent Nalchik businessman puts it, the Kremlin trusts local strongmen to keep things quiet and, “No one asks any questions.” Even in Russia few people take much interest in the north Caucasus. If it continues on its present ominous course, however, they will have to.

Mr Putin used the most heinous of Mr Basayev's outrages, the attack on a school in Beslan in North Ossetia in September 2004, as a pretext for scrapping the election of governors. Beslan also seemed to provoke a new tone in his foreign policy: Mr Putin fell back on classic anti-Western language, blaming unnamed foreign powers, motivated, he said, by unease at Russia's nuclear status. Later that year came the Kremlin's meddling in the presidential election in Ukraine, when Mr Putin publicly backed the fraudulent loser. Unable to grasp that other countries might work to different rules, the Kremlin saw the “orange revolution” as a coup, paid for by foreigners. Mr Putin's early commitment to integration with the West, it began to seem, like his commitment to democracy, had been a mere tactic, not an objective.

As he has grown into his presidency, and as the oil price has soared, Mr Putin's true philosophy has become clearer. He is not, as is often alleged, a neo-Soviet ruler: there is little trace of communism left in the Kremlin. The creed of the ex-KGB officers who make up much of his inner circle is better described as Chekism, which takes its name from the first Soviet secret police, the Cheka. Its basic tenet is that Russia's destiny is to be a great power, a greatness that must be fostered in the face of Western attempts to undermine it. “They understand that Russia is growing now, becoming stronger,” says the Kremlin's Mr Shuvalov of Russia's critics. So they “use any possible chance to criticise”.

The principal arena for the confrontation with the West has been the ex-Soviet states of Russia's “near abroad”, in which Mr Putin has defended what he sees as Russia's interests with ruthless pragmatism. Despicable but friendly regimes in Uzbekistan and Belarus are supported. Wayward ones in Ukraine and Georgia are punished. The manipulation of gas supplies has become a weapon in this contest. But Russia's policy in the Middle East, and its flirtation with China, are also part of the quest for great-power status. Dmitri Trenin, of the Carnegie Moscow Centre, argues that Russia has now left the Western solar system and is busily creating its own.

The burden of empire

Russia's curious path under Mr Putin—assertiveness and paranoia in foreign policy, centralised yet weak government—can perhaps be explained best by an old truth, that Russia is more an empire than a state, its rulers haunted by the fear that their domain will fall apart. Plenty of evidence, such as the widespread admiration for Stalin, suggests that many Russians share Mr Putin's evident belief that authoritarianism is the way to hold the place together. If that ancient conviction is right, and Russia is constitutionally unsuited to democracy, many of his failings are forgivable. To be upbeat about Mr Putin, in other words, is to be downbeat about Russia s future.

On the other hand, most ordinary Russians are woefully ill-informed about their past, as well as their present. Optimists hope that Mr Putin will prove to be merely a temporary coda to totalitarianism. They hope that the economic trends he has helped to create will eventually counteract, rather than reinforce, the political ones, and that Russians will become better informed and more assertive. Unfortunately, in a country where elections are only a way to legitimise choices made in the Kremlin, it is Mr Putin who will decide who and what follow him, if he leaves office, as he is supposed to, in 2008.

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The budget

And the money comes pouring in

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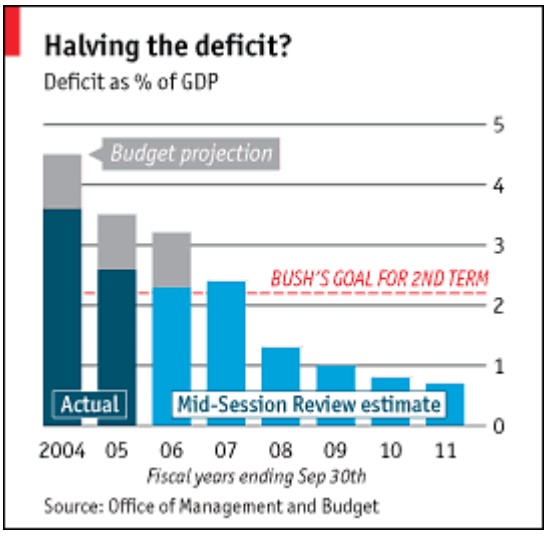
From The Economist print edition

Tax revenues are soaring and America's budget deficit is shrinking. But how long will this last?

WHEN it comes to summer reading, you might expect George Bush to favour *Field & Stream* and *Sports Illustrated*. Instead, he has been enthusing over the *Mid-Session Review*, a starchier production from the White House's budget office. The reason is simple. The numbers it contains seem wonderful.

Thanks to soaring tax payments, the budget deficit for fiscal 2006 (which ends on September 30th) is now expected to be $296 billion, or 2.3% of GDP, 30% lower than the White House expected only six months ago, and lower than last year's figure of $318 billion (2.6% of GDP). By 2008, Mr Bush's number-crunchers reckon, the fiscal gap will be down to 1.3%, well below the level needed to fulfil the president's election promise of halving the deficit in his second term (see chart).

The president, who badly needs to rebuild credibility with his conservative base, was ecstatic as he announced the numbers to the world. Not only was the deficit under control, he claimed, but soaring revenues were clearly the consequence of tax cuts and proof that Bushonomics works. “Some in Washington say we had to choose between cutting taxes and cutting the deficit,” he crowed. “Today's numbers show that that was a false choice.”



Outside the White House, the reaction to the new figures was rather less glowing. Many pointed out that a budget deficit of 2.3% of GDP at a time when the economy is booming and the baby-boomers are about to retire was hardly cause for great celebration. Others grumbled that much of the fiscal “improvement” was fake, arguing that the Bush team regularly overestimates deficits early in the year so that it can flourish better numbers later on.

The White House's February forecast of a $423 billion deficit was indeed far above other people's. Both the non-partisan Congressional Budget Office and economists on Wall Street expected a gap of about

$370 billion. But this week's budget “surprise” cannot be put down simply to financial legerdemain. The revisions almost all stem from higher tax revenues, a surge of cash that has shocked everyone.

The White House now expects to get $115 billion more in taxes this year than it was expecting in February. Against the boffins' expectations, a revenue surge that began in 2005 appears to be continuing. In 2005 tax receipts rose almost 15%, the fastest pace in 24 years. They now look likely to rise by another 11% this year, far above the historical average growth rate of around 7.5%. About half the surge in cash comes from firms; the other half is thanks to higher income-tax payments by individuals, particularly those that are not withheld from pay-cheques, such as tax payments on capital gains and bonuses.

These are impressive figures, but how much credit belongs to Mr Bush's tax cuts? Fiscal loosening doubtless cushioned the 2001 recession and may have accelerated the subsequent recovery. But the tax cuts cannot be given all, or even much, of the credit for today's strong revenues. Tax receipts often rise faster than the bean-counters expect during cyclical expansions. Since budget forecasting is more an art than a science, revenue “surprises” are common.

The prominence of corporate tax revenue is due largely to the peculiarities of the current cycle, in which wage growth has been remarkably weak and the share of the national economic pie going to firms' profits has hit a record high. This has nothing to do with tax policy. Profits have been unusually fat in other rich countries too, and Mr Bush did not cut America's corporate-tax rate. If anything, the expiration of temporary investment-tax breaks at the end of 2004 may be helping to boost corporate taxes.

Strong growth in profits also helps explain the recent surge in individual tax receipts, as capital gains and dividend income has soared. Moreover, tax payments on the profits of small businesses often show up as individual tax receipts. Another possible explanation is America's growing income inequality. In a progressive tax system, where richer people pay a higher average tax-rate, more income going to top earners automatically means higher tax revenue. Elsewhere, the tax cuts may well have swollen the cyclical rise in revenue. The capital-gains tax cut, for instance, may have temporarily boosted revenues as people sold long-held assets.

All told, Mr Bush's tax policy may have played a modest role in boosting a temporary revenue surge. But that is very different from suggesting, as the White House does, that tax cuts were the main cause or that they permanently pay for themselves. Most serious economists have long laughed at the idea that Mr Bush's tax cuts raise revenue. Now, it seems, the president's own boffins agree. Deep in the *Mid-Session Review* is a claim that the Bush tax cuts could eventually raise the level of GDP by 0.7%, a relatively modest effect, and one that itself depends on the tax cuts being financed by lower spending.

Look carefully, and Mr Bush's own forecasts do not expect the revenue boom to last. Tax receipts are expected to grow by only 2.4% in 2007, partly because Congress recently passed a law that would stem the rise in the number of people who pay the Alternative Minimum Tax (AMT), a tax originally designed to stop the rich taking too many deductions. The budget forecast, implausibly, assumes the number of AMT payers will soar again in 2008. Add together the cost of fixing the AMT and likely expenses for the war on terror, and the budget deficit may well stay around 2% of GDP for the rest of the decade.

That is an improvement on the recent past, but it is hardly a fiscal triumph. To his credit, Mr Bush has repeated the urgent need for reforms to pensions and the government's health-care system for the old, the two biggest drains on the public purse. Despite his diminished political standing, he seems keen to tackle these subjects next year. Sadly, by bragging about the rosy short-term budget figures, he may have made that task even harder.

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Immigration

The wrong side of history

Jul 13th 2006 | LOS ANGELES
From The Economist print edition

Wooing Latinos with one hand, bashing them with the other

THE backlash against the presence in the United States of some 12m illegal immigrants, four-fifths of them from Mexico and other parts of Latin America, is at full strength. Right-wing talk-radio and cable TV hosts rant about the “broken border” with Mexico; House Republicans talk of making felons out of the undocumented and those who help them. This week Colorado, with an estimated 250,000 illegal residents in a population of 4.7m, voted to deny state benefits, including non-emergency health care, to anyone who cannot prove legal residence. That law was modelled on measures already passed in Georgia and Arizona.

So how did the Latino lobby group, the National Council of La Raza (NCLR), have the power at its July 8th-11th convention in Los Angeles to attract so many star speakers from both sides of the political divide? For the Democrats, Bill Clinton, Antonio Villaraigosa, the mayor of Los Angeles, and New Mexico's governor, Bill Richardson, queued up to say nice things. So did the Republicans' Arnold Schwarzenegger, governor of California, Senator Sam Brownback of Kansas, and even Karl Rove, the White House deputy chief of staff, otherwise known as “Bush's brain”.

One answer is that the Latino vote needs to be wooed. For example, Mr Schwarzenegger, who upset many Latinos last year by casually voicing support for informal “Minutemen” patrols on California's southern border, will probably need around 30% of California's Latino vote to be re-elected in November. Democrats and Republicans alike worry that a few Latino votes here or there could help determine control of the House of Representatives or even the Senate.

Beyond November, the vote will continue to be very much worth pursuing. Excluding Puerto Ricans, some 42m Latinos live in America—around 14% of the population—and more than a third are younger than 18. That should mean plenty of new voters in future elections, not least because the NCLR, conscious that only 7.5m Latinos voted in 2004, is mounting a registration drive.

Heroes and felons

Because so many of them are either illegal or are related to illegal residents, Latinos are also at the centre of a Republican tussle that puts the Senate and George Bush on one side and the House on the other. Two years ago Mr Bush, calling for the reform of an immigration policy that has left “millions of hardworking men and women condemned to fear and insecurity in a massive, undocumented economy”, suggested matching enhanced border security with a guest-worker programme and a path towards legalising illegal residents. The Republican-controlled Senate, with support from Democrats, backed the president's plan with a bill (though it also added a 370-mile, or 600km, fence along parts of the southern border).

However, five months earlier the Republican-controlled House had taken a different line. It voted for a bill that would build a 700-mile fence along weak parts of the 2,000-mile Mexican border; would make no provision for guest-workers; would increase penalties for employers of illegal immigrants; would make it a crime to assist illegal immigrants; would make illegal immigration a felony, rather than a mere offence against civil law; and would certainly not give the “amnesty” of a path to citizenship for the undocumented.

In theory, some kind of compromise between House and Senate remains possible. Perhaps the House will be less insistent on criminal sanctions; perhaps the Senate will agree to “triggers” (such as proof of

secure borders) before a guest-worker programme can be introduced. But in the meantime, neither side is showing much appetite for a solution. The House Republicans, taking advantage of the coming summer recess, have started a series of “town-hall” hearings on the supposed defects of the Senate bill. The Senate is replying with similar hearings of its own.

To Mr Clinton, the reason is obvious. The conservative wing of the Republican Party sees immigration as “a way of creating a divided community and distracting people from the real challenges facing the country, whether it is in Iraq and Afghanistan, or homeland security, or how to build a clean energy future, or how to solve the health-care crisis, or how to create new jobs for America.”

Mr Clinton may be right. While Mr Bush keeps pushing the need for a guest-worker programme, albeit with hints that the “triggers” might be an acceptable idea, many voter-endangered Republicans see the electoral sense of keeping the immigration pot boiling. In California's 50th congressional district, for example, Brian Bilbray preached a hard line on immigration to win a special election last month. Similarly, Pennsylvania's Senator Rick Santorum, who is facing a tough fight for re-election, is suddenly emphasising that he voted against the Senate immigration bill.

In the short term, immigration as a “wedge issue” makes political sense. Whether it makes practical sense is another matter. New York's mayor, Michael Bloomberg, a liberal Republican, pointed out last week at a Senate town-hall hearing in Philadelphia that the Big Apple's economy would collapse without the half-million or so undocumented people among the city's 3m immigrants. The same, he added, would hold true of America as a whole.

In the longer term, does it even make political sense? For now, a hard line on immigration has populist momentum. But this will surely flag, as have the country's previous outbreaks of xenophobia, be they against Chinese, Japanese, Irish or even Norwegians, as the Nordic Mr Rove pointed out to the NCLR's convention. As Janet Murguia, the NCLR's president, said “The anti-immigrant demagogues are on the wrong side of history.”

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Impeaching the president

Cries from here and there

Jul 13th 2006
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Spasms of discontent at the grassroots

Get article background

AS THE mid-term elections creep nearer, few congressmen want to talk about impeaching George Bush. But a growing number of cities and citizens' groups are demanding it. Several reliably pinko city councils across the country, including Chapel Hill, North Carolina, Marlboro, Vermont, and San Francisco have passed resolutions urging impeachment, and state legislatures in Vermont, California and Illinois have resolutions pending. On November 7th the “People's Republic” of Berkeley, California—71,000 voters, roughly 5% of whom are registered Republicans—will decide by ballot whether they want the president out, and presumably say yes.

Berkeley's move has caused much ridicule on conservative TV channels, yet a grassroots movement of sorts is developing. Last year the Centre for Constitutional Rights laid out its legal case against the president: spying on American citizens, lying to them about the Iraq war, seizing undue executive power and sending people to be tortured overseas. Now the centre and a dozen other organisations have teamed up for a “National Teach-In”, starting on July 19th. Meetings will feature a short film called “How to Impeach a President”.

A few Democrats in Congress are talking of censure and investigations, and popular momentum, if it gets going, could make them bolder. Moreover, state resolutions may have bite. The House *Rules and Manual* states that one method of setting an impeachment in motion is by charges “transmitted from the legislature of a state or territory”.

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Terrorism

In retreat

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George Bush's climb-down over the Geneva Conventions

FOR the first time, the Bush administration has conceded that “unlawful enemy combatants” captured in America's global war on terror are entitled to minimum protections under the Geneva Conventions. This is the latest in a series of humiliating retreats forced on the president since his announcement, after September 11th 2001, that he planned to fight a new kind of war with new rules.

Invoking his constitutional war-time authority as commander-in-chief, George Bush and his aides proclaimed that he could do pretty well whatever he liked to protect the nation. The leading advocates of this view of executive power, unprecedented in its breadth, were David Addington, a former vice-presidential counsel (now chief of staff to the vice-president), John Yoo, a former Justice Department lawyer (now back in academia), and Alberto Gonzales, the former White House counsel, now attorney-general.

But others, like John Bellinger, the current State Department legal adviser, and his predecessor, William Taft, have long urged a more measured approach. They understand that it does America no good to appear indifferent to international laws, and have put much effort into softening the cavalier language and policy that have come from the White House and the Pentagon. From the outset they argued, for example, that al-Qaeda detainees at Guantánamo Bay, in Cuba, were protected by the Geneva Conventions' Common Article 3—the position taken by the Supreme Court in its ruling on June 29th. That article guarantees the right of detainees to be humanely treated and, if charged, to be tried by “a regularly constituted court, affording all the judicial guarantees”.

The administration's change of heart, forced on it by the Supreme Court, was outlined in a Pentagon memo, released on July 11th. Tony Snow, the White House spokesman, insisted that it did “not really [mark] a change of policy” as detainees were already being humanely treated. But he failed to mention the special military commissions set up by Mr Bush to try the Guantánamo detainees, which exclude defendants from attending certain hearings and bar appeals against conviction. The Supreme Court said the tribunals violated both domestic and international laws, adding that, in its view, courts-martial would be the best way to try detainees.

But the administration is now urging Congress to amend, rather than scrap, the military commissions. In testimony to the Senate Judiciary Committee, Daniel Dell'Orto, a Pentagon lawyer, protested that courts-martial would require “our fighting men and women to take on additional duties traditionally performed by police officers, detectives, evidence custodians and prosecutors.”

But senior Republican lawmakers said they were unlikely to accept the administration's position, preferring to adjust traditional courts-martial to allow looser hearsay evidence and other exceptions for classified information. Little by little, the president's limitless view of his authority is being challenged and curbed.

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Fake parks

Dubai in America

Jul 13th 2006 | CHARLOTTE, NORTH CAROLINA
From The Economist print edition

AP

Nature's rapids look rather more appealing

Let's ski in Dallas and surf in Orlando

THE sight of bulldozers hauling rocks into concrete riverbeds may make nature-lovers weep. But the National Whitewater Centre in Charlotte, due to open next month after several delays, seems just right for the 21st century. It boasts the longest artificial whitewater-rafting course in the world (one mile, but with the assumption that you go around several times on each trip). Olympians plan to train there. Jeff Wise, executive director of the $35m project, talks of bringing the outdoor lifestyle “to the people”.

Not everybody is lucky enough to live, or take their holidays, in the mountains. That is a big reason why fake parks—activity parks that mimic nature—are taking America by storm. The $11 billion theme-park industry may be slowing (to a 3.9% annual rate of spending growth until 2010, according to PricewaterhouseCoopers), but recent years have seen an explosion of indoor waterparks with slides and whirlpools, a family-friendly trend started in the garish Wisconsin Dells. Beth Robertson, an amusement-park industry spokesperson, describes waterparks as the “hottest artificial experience in the United States”. Galveston Island in Texas has just opened the world's first convertible waterpark, where the roof stays open in sunny weather and closes for storms, for uninterrupted fun.

Developers' ambitions are growing. The Ron Jon Surfpark in Orlando, due to open early in 2007, claims to be the first built specifically for surfers and bodyboarders. Waves of up to eight feet (2.5 metres) will roll 60 to 100 yards down a big salt-water pool. Lest winter-sports types feel overlooked, a ski resort is being planned—in Dallas. The hill will be 220 feet tall, covering 68 acres, according to Jeff Green, the chief executive of Bearfire Group, a developer. A property deal is expected any day. If ground is broken this year the park, called “CoolZone Winterplex”, could open as soon as 2009.

Is America catching up with Dubai, home of desert skiing, the world's only seven-star hotel and other outlandish attractions? Nature, clearly, is too inconvenient to fit the modern lifestyle. Ray Petro, who started an indoor mountain-bike park in Cleveland (the world's first, of course), boasts of being able to “beat Mother Nature”. (His park, which opened in 2004, does shut down during summer when everyone is out of doors.) The Ron Jon Surfpark hopes to lure east-coast surfers who long for California-quality waves. As for skiing in Dallas, it surely trumps the mall.

New technology is making all this possible. The Dallas ski area will not use conventional snowmaking machines. Instead, it will feature an artificial surface designed in Britain. In the past, according to Mr

Green, the surface material has been too lattice-like (and thus dangerous) for proper skiing, but a British engineer has solved this. The result is a “fairly fast surface”. The Ron Jon park will feature a moving floor to create differently shaped waves, says Bob Baydale of Baker Leisure Group, the park's management company. That sounds vastly better than the dull, predictable ocean.

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Indoor rainforests

Rejecting Eden

Jul 13th 2006 | IOWA CITY
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Why the tropics won't be coming to Cedar Rapids

AS A student from Des Moines in the 1960s, Ted Townsend fell in love with the tropical rainforest. As CEO of a thriving family business some 35 years later, he proposed to build one back home. This complex of biomes, with an integrated aquarium and a garnish of native prairie, is now known as Earthpark. Mr Townsend presented his brainchild to a sceptical world on September 10th 2001: not the best day, as he admits, to launch a visionary environmental initiative.

Iowa's senior senator, Charles Grassley, who chairs the Senate Finance Committee, kindly steered $50m to Earthpark in the 2004 appropriations bill. Yet despite this federal windfall, declared funding fell short of estimated cost by over half. And though, in principle, an indoor rainforest in Iowa is no more bizarre than the Eden Project in Cornwall, which pulls in 1.4m visitors a year, state businesses are still unpersuaded that Earthpark can draw the crowds or charge enough to break even, and no town has yet ponied up the $25m stake its organisers are asking for.

Des Moines, Iowa's capital, was the first to say no. Then came Cedar Rapids, the state's second city. A strenuous courtship with Coralville on busy Interstate 80 ended last winter without wedding bells. Mr Townsend's board is packed with the great and good of the state; Grimshaw, the London-based architects of the Eden Project, have signed on as Earthpark's designers; and in May Siemens, hoping that Earthpark might show off its products in a state with a promising future in ethanol and wind power, offered eight digits' worth of marked-down prices and the latest green high tech. But the clock is running. Without matching funds, the federal grant will wither in December 2007.

With the project still homeless and another town dropping out last week, it now seems that Riverside, a village of about 1,000 souls south of Iowa City with a shiny new hotel, casino and golf course, is the likeliest bidder. Kelly Hayworth, Coralville's city administrator, puts the likelihood that the project will be built at 20%. But David Oman, Earthpark's executive director, reminds critics that South Dakota took ages to embrace Mount Rushmore, and that St Louis took 16 years to agree to Eero Saarinen's spectacular Gateway Arch.

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Lexington

A weakened branch?

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Congress has had a lousy few years. It may be about to do better

IT IS hard to look at the Capitol in Washington, DC, without a frisson of excitement. It is not just the physical grandeur of the place—though a 290-foot (88-metre) dome and a quarry's worth of marble certainly helps. It is also what it symbolises: the legislative heart of the world's mightiest country. Where else in the world do lawmakers discuss highway bills worth $300 billion? Or thrash out their views of what should be done with such satrapies as Afghanistan and Iraq?

Yet this mighty institution is in a terrible mess. The list of congressmen who have been stretching the rules gets longer by the day. William Jefferson, a Democrat from Louisiana, was found with $90,000 in his freezer; John Doolittle, a Republican from California, has been allowing his wife to take a 15% commission for raising funds for his political action committee. But Congress's problems are more than a matter of a few bad apples. There is something seriously wrong with the whole tree.

The Founders wanted Congress to be the first branch of government—the one organisation that truly represented a vast and diverse country. They also wanted it to exercise careful oversight over the executive branch. But under George Bush Congress has been marginalised and neutered, with its leaders judging that their most important job is to push through the president's agenda. This has not only meant abandoning oversight (the majority is forever stuffing bloated last-minute amendments into already bloated bills). It has also meant bending the rules: during the passage of the Medicare prescription-drug benefit, the Republicans extended a roll call from the conventional 15 minutes to three hours until it could cobble together a majority.

If Congress is failing to control the executive, it is also failing to control itself. Congressmen have been spending ever less time on the people's business. In the 1960s and 1970s, the average Congress was in session for 323 days. So far, the average under Mr Bush has been less than 250 days. And when the members have been working, pork-gorging has occupied much of their time. Citizens Against Government Waste calculates that pork-barrel spending has exploded from 1,439 projects worth $10 billion in 1995 to 13,997 worth $27.3 billion in 2005. The “emergency” bill for Hurricane Katrina and the Iraq war included $1.8m to promote art in West Virginia.

The most obvious result of Congress's failure to play its proper role has been lousy legislation: the Medicare prescription-drug act, for example, an exercise in deceptive accounting that will add billions to unfunded liabilities, or the highway bill, a porkfest that actually included a $223m bridge to nowhere. Another result is lousy oversight of the executive branch. Would Mr Bush have been able to get away with invading Iraq with such sketchy plans for reconstruction if Congress had been doing its job? And would the Department of Homeland Security have developed into such a disaster if Congress had been more critical from the start? Opinion polls put public support for Congress at less than 30%. The wonder is that the figure is so high.

Why has Congress sunk so low? For the answer, it is best to consult two Washington veterans, Tom Mann of the Brookings Institution and Norman Ornstein of the American Enterprise Institute, who can claim 72 years of Congress-watching between them. Now the two have put their thoughts into a book, “The Broken Branch: How Congress Is Failing America and How to Get It Back on Track” (Oxford University Press).

Messrs Mann and Ornstein resist the temptation to look at congressional history through rose-tinted spectacles. Duels were once commonplace, as were fights with fists and firetongs. In the 1850s one senator beat another unconscious. Congress has seen other periods of overweening executive power (when Alexander Hamilton was treasury secretary, and when Richard Nixon was president) and vicious partisanship (in the 1890s and 1900s). But the authors nevertheless argue that they have never seen things this bad. This is partly because Congress now has far bigger responsibilities—America's GDP is more then $12 trillion and the federal budget is approaching $3 trillion—and partly because Congress's behaviour is going from bad to worse.

Signs of resistance

According to Messrs Mann and Ornstein, Congress's current problems stem from three things. The first is a president with soaring ambitions (including reordering American foreign policy and entrenching Republican power) and an executive-focused view of the constitution. The second is an upsurge in partisanship in which the Republicans, though with slim majorities in both houses, are playing the politics of win-at-any-cost. The third factor is September 11th and the “war” that followed, which has given the Bush administration licence to treat the legislative branch with contempt. The result is that the Madisonian system of checks and balances has metamorphosed into something akin to a parliamentary system.

Can anything be done to fix the broken branch? Possibly, the problem is already starting to correct itself. Congress is getting less deferential by the day. Pete Hoekstra, the chairman of the House Intelligence Committee and a former Bush loyalist, confirmed on Sunday that he had sharply criticised Mr Bush for keeping him in the dark about an intelligence programme. Last month's Supreme Court ruling on Guantánamo has emboldened Congress still further: one reason why the administration embraced the Geneva Conventions is that it realised that it had little chance of getting its preferred solution through Congress. “We are not a parliament, and when we function like a parliament we're unfaithful to the process and our system of government,” says Christopher Shays, a Republican who is presiding over hearings on the administration's strategy in Iraq. After his recent slumbers, Madison's shade is stirring at last.

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Mexico's elections

A nation awaits

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AP

With court challenges under way, a clear winner looks unlikely before September

ON JULY 12th demonstrations in support of Andrés Manuel López Obrador swept Mexico. But they were not what the presidential candidate of the centre-left Party of the Democratic Revolution (PRD) had hoped for in his last-ditch bid to be proclaimed the victor. Although Mr López Obrador has called for a massive rally in Mexico City on July 16th in protest against alleged fraud in July 2nd's election, the gatherings around the country have so far attracted protesters only in the hundreds, and the thousands, rather than the hundreds of thousands.

According to the final official count by Mexico's independent Federal Electoral Institute (IFE), Felipe Calderón, the candidate of President Vicente Fox's centre-right National Action Party (PAN), pipped Mr López Obrador to the post by just 0.58%, or 244,000 votes. Although Mexico City's former mayor had been ahead for much of the count, he fell behind as late results from states supporting Mr Calderón came in. He is now contesting the vote.

The final outcome rests with a special electoral court, known by its Spanish acronym, Trife, whose decision is final. It will evaluate challenges to the count made by all three main parties. Mr López Obrador is disputing the count in 50,000 of the country's 130,000 polling stations; the PAN is contesting it in 1,500, and the PRI in 800. Mr López Obrador is also challenging the vote on the ground that government intervention—notably advertisements by Mr Fox lauding the government's achievements—gave him an advantage.

Although some of Mr López Obrador's challenges may be legitimate, he seems to be making some illegitimate ones. At a press conference on July 10th, he presented two videos allegedly showing irregularities, which now appear to be bogus. One of them showed a man stuffing a ballot box. But it turned out that the man, who is a schoolteacher and the local electoral overseer, was transferring presidential ballots, which had mistakenly been placed in the legislative ballot box, to their correct place. The local PRD representative has confirmed that it was done correctly.

The Trife has until the end of August to make a decision about any alleged irregularities, and must announce its decision by September 6th. It is likely to take its full allotted time. Composed of seven independent judges, the court has broad powers, though these have never been used before in a presidential election. It can certainly order recounts, or even annul the vote, of specific polling stations,

though it is not clear whether it could order a total recount or annul the election entirely. According to Fernando Franco, a former Trife judge and now a professor at ITAM, a university in Mexico City, a failure by the court to declare the vote valid by the September 6th deadline would be tantamount to annulling the election.

But, as Mr Franco notes, there is a presumption of validity. The court would have to find extraordinary evidence that the election was flawed to take such a step. This seems unlikely. No evidence of systematic irregularities has yet surfaced. Some errors have been found in the overall tabulation of votes but, according to José Woldenberg, the respected head of the IFE during the 2000 elections, these are likely to cancel each other out without affecting the overall result. Independent EU observers said the IFE had been impartial. Mr López Obrador's claim that Mr Fox is a “traitor to democracy” is rooted in the president's persistent attempts to prevent him from even entering the race. But in ending seven decades of rule by PRI, Mr Fox is also regarded as one of the founders of Mexico's nascent democracy.

Mr López Obrador's legal case is hurt by the fact that his own party representatives signed off on the count in many of the polling stations where he is now challenging the vote. The former mayor is now insinuating that some of them may have been paid off. But in more than a quarter of the stations, the PRD did not even have a representative present.

Mexico's financial world seems much more concerned with what happens after December 1st than with the short term. In the expectation that the current political crisis will be resolved by legal means, neither Standard & Poor's nor Fitch, two rating agencies, have changed their ratings of government bonds. Although interest rates inched up at the most recent auction of government debt and most people expect the peso to fall, this is due as much to external factors (such as rising American interest rates) as to electoral uncertainties. Meanwhile, the jittery Mexican stockmarket has been rising with every bit of good news for Mr Calderón, and falling with every sign that Mr López Obrador might still have a chance.

In all probability the market will settle down as it, like the rest of Mexico, gets used to the long wait until September 6th. What is needed now is patience. It is far from ideal that the final decision over who becomes Mexico's next president rests with the seven individuals who sit on the Trife rather than the millions of Mexicans who voted on July 2nd. But the court has established a track record of impartiality, ruling in favour of the three major parties in almost equal proportions over the past decade. Further, the court's judges are barred from any other government post that might have been affected by their decisions for two years after their terms end. Six of the court's seven judges end their ten-year terms in October.

Regardless of how they rule, a large portion of the country is sure to be unhappy. But the 1996 reform that empowered the Trife as the final arbiter of any election is far superior to what came before, where a simple majority of the lower house of Congress sufficed to declare a vote valid.

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Falkland Islands

A new war of words

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From The Economist print edition

Argentina launches a new offensive to dispute the islands' sovereignty

ONCE again the Falkland Islands, in the South Atlantic, are under assault. In London preparations are already under way to celebrate the 25th anniversary next year of Britain's victory over Argentina in the Falklands war. But if Argentina's president, Néstor Kirchner, gets his way, Britain will not be celebrating for long. Backed by his Venezuelan counterpart, Hugo Chávez, Mr Kirchner has launched a new verbal offensive over the islands' sovereignty, claimed by both Argentina and Britain.

Although the first landing on the islands (in 1690) was by an Englishman, the first settlement (in 1764) was actually French. Two years later, the colony was handed over to Spain. In 1833, Britain sought to assert its claim to the islands, situated some 300 miles (480 km) north-east of Argentina's southern tip, by establishing a naval garrison there. The islands' sovereignty has been in dispute ever since.

In April 1982, Argentina's military dictatorship invaded the Falklands, holding them for 73 days until a British expeditionary force recaptured them, at a cost of 649 Argentine and 255 British lives. When the two countries resumed formal relations in 1989, they set up a “sovereignty umbrella”, under which they agreed to co-operate on practical issues, while maintaining their separate claims to sole possession of the islands. This has enabled the establishment of commercial flights between the Falklands and Argentina, the construction of a memorial on the islands to the Argentine war dead and collaboration over fishing licences.

But in 2003 Mr Kirchner, then the combative governor of Santa Cruz province in Patagonia directly opposite the Falklands, won Argentina's presidential election. Convinced that the sovereignty umbrella had done little to improve Argentina's chances of regaining control over the islands, he has been picking away at it ever since. One of his first foreign-policy acts was to stop charter flights between the islands and the mainland.

In 2005, he upped the ante by refusing to send Argentine scientists to the bi-national commission that decides fishing policy for the region, in protest against a new Falklands' law extending fishing permits for up to 25 years. Last year, his foreign ministry sent the British embassy in Buenos Aires 15 letters of protest over the islands, instead of the normal one or two. In an attempt to rally neutral nations to its cause, Argentina has also been stiffening its criticism of Britain in the Organisation of American States and at the United Nations. Its Congress is now considering a plan to impose sanctions on all companies doing business in the Falklands.

The islands are certainly of economic interest. Sales of fishing licences bring in around $40m a year, and seismic studies suggest there may be reserves capable of producing up to 500,000 barrels of oil a day in the surrounding waters. The islands' estimated GDP per head of $25,000, measured by purchasing power parity, is by far the highest in Latin America and on a par with personal incomes in Spain, New Zealand and Israel.

This month Mr Kirchner and Mr Chávez met in Buenos Aires to sign a document calling for urgent talks between Britain and Argentina to reach a “peaceful, just and definitive solution to the sovereignty dispute...including the principle of territorial integrity”. Mr Chávez annoyed the British when he claimed earlier this year that the Malvinas, as they are called in Spanish, belonged to Argentina and told Britain to hand them over.

The timing of Mr Kirchner's latest moves suggests that he may be trying to whip up patriotic support ahead of next year's presidential campaign. “Dialogue, diplomacy and peace do not mean living with our heads down,” he declared on April 2nd, the anniversary of the invasion. “[They mean] defending our

rights over the islands with dignity.” Ironically, the president, who campaigned on a firm repudiation of Argentina's former military dictatorship, now seems to be taking a page from the generals' own copybook: the junta launched the 1982 war to boost its sagging popularity and remain in power.

But although this may help Mr Kirchner at the polls, it will not help him get the Falklands. Britain insists that, regardless of how many countries Argentina can line up in support, it will never discuss the sovereignty question with the government in Buenos Aires unless the islands' 3,000 inhabitants, who consider themselves British, request it. Tough talk from Mr Kirchner will only alienate them further. “We believe it would be morally unacceptable”, says a British embassy spokesman, “to force them to change their government.”

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Canada's health-care system

Still waiting

Jul 13th 2006 | OTTAWA
From The Economist print edition

Stephen Harper fails to deliver on a crucial campaign promise

WHEN Stephen Harper, prime minister of Canada, summed up the record of his first five months in office, he could justifiably boast that four of his five campaign “priorities” had been met. Since being sworn in on February 6th, he has introduced legislation to make bureaucrats and politicians more accountable and cut the federal sales tax from 7% to 6%. He has created a new C$100-a-month ($88) payment for child care and brought in a bill to crack down on street crime. But the glaring omission from that list is the one issue Canadians care most about: guaranteeing speedy access to public health care.

The Patient Wait Times Guarantee, under which patients would be transferred to another province or even to America for treatment if they did not receive attention within a specified time, was always an odd item for Mr Harper to put on his list. Stories of patients waiting up to two years for a hip replacement or ten months to see an orthopaedic surgeon have stirred public anxiety. But health care in Canada is a provincial responsibility, not a federal one. And although the provincial premiers happily accept federal money—including the extra C$41billion over ten years promised in 2004—they fiercely resist instructions on how to spend it.

Mr Harper's current strategy is to blame failure on the provinces. Earlier this year Tony Clement, the health minister, angrily told his provincial counterparts to “get off the pot” and produce a waiting-times guarantee. The premiers protest that they are making progress, but that a guarantee is not as simple as Ottawa makes out. They received support in a report last month by Dr Brian Postl, the federal adviser on waiting times, who was appointed by the previous Liberal government.

Long waiting times were a symptom of a much bigger problem, Dr Postl said: there could be no quick fix. Before a guarantee could be issued, a series of system-wide changes was required, ranging from the common-sensical, such as increasing the number of doctors using computer records (only 14% do so at present), to the more innovative, such as using the queuing theories used by air-traffic controllers and amusement parks. Canada might also take a look at countries like Britain, which have had some success in cutting their waiting times, he suggested.

This was not what Mr Harper wanted to hear. He now finds himself stuck in the uncomfortable position of having promised something that it is not in his power to deliver. But a landmark decision by Canada's Supreme Court last year could put fresh pressure on the provinces. The court ruled that Quebec was obliged to provide timely medical treatment or allow patients to pay personally for such services. But to get his promised guarantees, Mr Harper will have to stop sitting on the sidelines and engage the premiers directly.

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Brazil

No black and white matter

Jul 13th 2006 | RIO DE JANEIRO
From The Economist print edition

A new attempt to distinguish among Brazil's many colours

THINK of Brazilians, and a dizzying palette comes to mind. Half a millennium of mingling by Africans, Europeans and indigenous Indians gave this New World nation a hundred faces and more colours than Crayola. One national household survey turned up no fewer than 136 terms by which Brazilians classified their complexions, from “snow white” to “cinnamon”. The record-keepers, hoping to tidy things up, reduced the official racial types to just five: white, oriental, indigenous, black and *pardo* (brown). But to this day most Brazilians simply shrug and say they are a mixed-blooded people.

In many ways, this fluid self-image has been at the centre of the country's identity. But if the advocates of new racial politics have their way, this whole concept could change. Brazilian lawmakers are now weighing two bills that would shake things up, making four decades of American job-preferment policies pale by comparison.

The Racial Quota Law and the Racial Equality Statute would create a sweeping system of racial preferences in universities, the civil service and the private sector. An initial quota of 20% (rising later to nearly 50%) of senior civil-service jobs and vacancies at federal universities are to be set aside for those of “African” ancestry. The doors would also be opened to the poor, to Indians and, under a separate statute, to the physically handicapped. If all this became law, Brazil's complex collage could become a portrait in black and white.

Nobody disputes the arguments for such legislation, only its effect. Even 118 years after slavery, the racial divide still runs deep. Except on the football pitch and in music, or during the fleeting days of carnival, precious few of the 80m black and brown Brazilians ever rise to commanding heights in business or public life. *Negros* and *pardos* spend a third less time in the classroom than whites, earn half the wages and are far more likely to be out of work. “Anyone who looks at the numbers honestly can see where blacks are in society—at the bottom,” argues David Raimundo dos Santos, a Franciscan friar and champion of racial quotas. “We need quotas to create social unity.”

Others are not so sure. More than 500 Brazilian scholars, artists and other worthies, among them Caetano Veloso, a pop music idol, are calling on Congress to reject quotas. Imposing on a multi-hued society rigid quotas of white and non-white, they say, is not only artificial but risky. Ominously, a few of the universities that already use quotas have created evaluation committees to police student applications for possible “race fraud”.

“If you have a society that is based on sameness, you shouldn't throw that away,” says Peter Fry, an anthropologist who has studied race and racial politics in Africa and Brazil. “One defect Brazil doesn't have is outright racial strife, and a battle over who is black or white could create that.”

Far better and fairer than quotas, the contras argue, would be to create a broad system of universal incentives—study grants and tutorials for the poor, for instance—that would reach all Brazilians, whatever their complexion. But if centuries of colour-blindness have failed to better the lot of the black and the brown, it is unlikely that the same society will improve the plight of an even greater number of multi-coloured Brazilians.

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Terror in Mumbai

Call this peace?

Jul 13th 2006 | DELHI
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AFP

Another terrorist atrocity; another obstacle to peace between India and Pakistan

EVEN for a city that has suffered more than its fair share of terrorist outrages, it was a shocking enormity. The almost simultaneous bombing of seven trains and stations along Mumbai's main suburban railway line on July 11th killed close to 200 people and injured 700. “Mumbaikars” responded with unfussy heroism. Rather than flee the horror, many blood-streaked survivors stayed to help; others rushed to the scenes of the blasts. As Manmohan Singh, India's prime minister, said in a televised speech: “Mumbai stands tall once again as the symbol of a united India; an inclusive India.”

It also, however, has an ugly history of sectarian violence. This was the worst terrorist onslaught since a series of co-ordinated bombings in 1993, which killed more than 250 people. Those were blamed on an unholy alliance of Islamist extremists, Pakistan's intelligence service, and some of the leading dons of Mumbai's underworld, who happen to be Muslims. The attacks were seen as revenge for the demolition, in December 2002, of a mosque in the Hindu holy city of Ayodhya.

The city still has violent religious zealots. Members of the Students' Islamic Movement of India (SIMI), an extremist group banned in 2001 with links to Pakistan-based outfits, are believed to survive and plot terror, such as a double bombing in August 2003 that killed more than 50 people. That, too, was seen as part of a bloody cycle of vengeance—for a pogrom in the state of Gujarat the previous year, in which perhaps 2,000 Muslims were slaughtered. Some observers have suggested that these latest bombs, secreted in the trains' first-class carriages, were aimed in particular at well-to-do Gujarati residents of Mumbai.

Others pointed to violence on July 9th, when supporters of Shiv Sena, a Hindu-fundamentalist party with a record of thuggery, went on the rampage, blocking roads, burning cars and forcing shops to shut. They were protesting against the defacing of a statue of Meenatai, the wife of the movement's founder and demagogue, Balasaheb Thackeray.

The July 11th attacks, however, were too meticulously planned and too efficiently executed to be dismissed as spontaneous retaliation in a campaign of tit-for-tat communal violence. The police, intelligence services and media assumed the involvement of SIMI, with the support of a terrorist group fighting Indian rule in Kashmir, Lashkar-e-Taiba, whose headquarters are in Pakistan. There has been a

series of terrorist attacks in India over the past year, blamed on Lashkar: in Ayodhya and another Hindu holy city, Varanasi; in Nagpur, headquarters of the Rashtriya Swayamsevak Sangh, a Hindu-fundamentalist organisation; and, most bloodily, in Delhi, last October, when 60 people were killed.

Even on the day of the Mumbai terror, there had earlier been five separate grenade attacks in Srinagar, capital of Indian Kashmir, in one of which, on a bus, eight people were killed. In another, on a tourist reception centre, a crowd caught the grenade-tosser. The police said he was from Lashkar.

The police also claimed they had intelligence from another captured Lashkar militant giving warning of just such an attack on Mumbai's railway. In Pakistan the country's leaders, and indeed those of Lashkar itself, condemned the bombings. Lashkar denied all involvement and disowned the man caught in Srinagar. But that was only to be expected. India and Pakistan are now three years into a peace process, which has made huge strides in reducing tension. But it is based on a bargain both sides suspect the other of breaking: that Pakistan will rein in the terrorists operating from its soil, and that India will negotiate in good faith over the central dispute, the future of Kashmir.

In May, India's defence minister, Pranab Mukherjee, said India had “confirmed information” that 59 training camps for militants were still being run in Pakistan-controlled territory. So perhaps Lashkar's denial itself had “plausible deniability”. It would not want to embarrass its Pakistani sponsors by boasting of its murderous achievement. But it would also want to send the signal that the terrorist weapon remains in its (and Pakistan's) armoury, should India not compromise on Kashmir.

That is why India reacted so sharply to remarks about the bombings made by Khurshid Kasuri, Pakistan's foreign minister. He suggested that, in the absence of a Kashmir settlement, “negative forces” would flourish. India, predictably, described the apparent linkage of “this blatant and inhuman act of terror” to the progress of talks on Kashmir as “appalling”. Mr Kasuri seemed to suggest, India's foreign ministry spokesman charged, “that Pakistan will co-operate with India against the scourge of cross-border terrorism and terrorist violence only if such so-called disputes are resolved.”

Progress and frustration

Pakistan claimed Mr Kasuri had been misinterpreted. But his government's frustration at the snail's pace of the diplomacy is no secret. “This peace process,” Mr Kasuri said recently, “unless it gains momentum, can be unravelled, and we can be back to square one.” Kashmir remains the bugbear. Separatist leaders in the Indian part complain that human-rights abuses persist, fostering militancy among indigenous

Kashmiris, and resentment in Pakistan.

It is not just over the big questions of Kashmir's future, however, that progress is slow. A pointless dispute, costly in lives and treasure, over the Siachen Glacier, is proving intractable; the two countries have failed to agree land and sea borders in the Sir Creek region along the Gujarat coast; and they continue to quarrel over sharing Kashmiri river waters.

If the unstated intention behind the Mumbai slaughter was to make India negotiate faster, it had, predictably enough, the opposite effect. India stalled in naming the dates for a scheduled meeting of India's and Pakistan's top diplomats to review progress in their “composite dialogue”. The unravelling of the peace process would be Pakistan's loss, of course—India can live with the status quo. But the puncturing of the dream of lasting peace would be India's loss, too. The only winners would be the terrorists.

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The Koreas

Sunshine and storms

Jul 13th 2006 | SEOUL AND TOKYO
From The Economist print edition

South Korea's "sunshine policy" continues, for lack of anything better

IN THE week after Kim Jong Il of North Korea fired off seven missiles towards the Sea of Japan, including a long-range ballistic Taepodong-2 that self-destructed soon after take-off, every country with a stake in North Korea's future—even its sole ally, China—has publicly denounced the action. Every country, that is, except South Korea. North Korea is still technically at war with the South, along whose border it masses artillery, tanks and troops. Yet since 2000, South Korea has pursued a "sunshine policy" towards North Korea that attempts to engage the hermit state with political dialogue and economic blandishments. Doggedly sunny, the government seems determined not to let this crisis push it off course.

South Korea's president, Roh Moo-hyun, has managed not even to acknowledge the missile firings yet in public. Instead, an odd notice has been posted on the presidential website. Domestic critics of the president's light-handed approach, the notice said, were stuck in the cold war, when South Korean dictatorships would exaggerate the threat from the North in order to increase their control at home. The firing of the Taepodong-2 constituted no crisis, because "it was not aimed at any particular party." Japan, rather than North Korea, came in for criticism in the presidential notice: "There is no reason to fuss over this from the break of dawn like Japan, but every reason to do the opposite." South Korea's opposition has slated the government for this stance.

But official criticism of Japan has since grown stronger. Some Japanese officials, including Shinzo Abe, the chief cabinet secretary and likely successor to Junichiro Koizumi, the prime minister, have this week raised the possibility of pre-emptive strikes at North Korean missile facilities should an attack on Japan look imminent (though Japan at the moment lacks the capability actually to do it). This brought apoplexy from a presidential spokesman in South Korea, who said it "exposed Japan's tendency to invade" other nations; Japan, not North Korea, was responsible for tensions on the peninsula.

South Korea's assiduously muted criticism of North Korea admittedly hides deep concern. Without fanfare, the government said last week that it is suspending the shipments of food and fertiliser on which North Korea depends. Though a planned inter-Korean ministerial meeting this week went ahead in the southern port city of Busan, the government in Seoul stressed that it would not focus on the usual economic exchanges, but rather on the missiles and on stalled negotiations over North Korea's nuclear-weapons programmes. The talks duly broke down. However, business is to continue as usual at Kaesong, the inter-Korean economic zone just across the border in the North.

South Korea's policy of engagement, then, if North Korea itself does not scupper it, is likely to continue. For all the growing debate in South Korea about what the country is getting in return for the sunshine, there is little appetite for an alternative. Among much of the public, an insouciance exists about the North Korean threat. Most South Korean policymakers seem to think that Mr Kim's regime, acutely aware that it has long lost both the economic and military advantage, will strike out only if isolated and provoked.

This means that South Korea's tensions are guaranteed to continue not just with Japan, which is robustly pushing for stronger measures against the North, but also with America. At bottom, South Korea and its ultimate guarantor want different outcomes. President George Bush professes a visceral hatred of Mr Kim, and hopes that the regime will collapse under a combination of internal contradictions and outside pressure. South Korea's engagement policy aims to avert such a collapse, which would present a huge and costly challenge to the South—better, instead, to help North Korea towards prosperity. In polls, South Koreans say they want reunification, but the overwhelming majority believe it should be deliberate, well-planned—and always at least a decade away.

This week, as *The Economist* went to press, events seemed to be going South Korea's way. Japan agreed to shelve, at least for a few days, a UN Security Council resolution calling for sanctions on North Korea, backed, if necessary, by force. This was intended to give Chinese diplomacy with North Korea a chance to work—China's deputy foreign minister, Wu Dawei, left for Pyongyang on July 10th. Mr Bush's administration also said it was keen to see China rein in a wayward ally. But if such diplomacy fails to get North Korea back to multi-party negotiations, then South Korea's sunshine will stand in growing contrast to American and Japanese hostility towards the North.

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Indonesia

Brightening skies over Aceh

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The government hands provincial autonomy to Aceh

THE chances of lasting peace in Indonesia's unhappy northern province of Aceh brightened on July 11th. A law was passed granting it generous autonomy, as promised last August in a pact between the government and the separatist Free Aceh Movement (GAM), which formally ended a 29-year armed struggle. According to the new law, the Acehnese will receive tens of millions of additional dollars from the government; they will keep 70% of the revenue from their large oil and gas reserves; and they will have a bigger say in the running of their province. For the first time in Indonesia, local political parties will be allowed in Aceh. Since these will not be formed in time to contest provincial elections expected in November, individual candidates will be allowed to stand as independents, another first for Indonesia.

Many Acehnese politicians reckon all this has satisfied about 90% of their demands. Others are less content. GAM has lingering concerns over whether the government will honour its agreement. And many Acehnese are furious that a promised human-rights tribunal will have no powers to investigate crimes committed during the long conflict. Some Acehnese fears are more personal. Many women, for instance, predict that the formal adoption of Islamic law, another fruit of the peace agreement, will erode their already meagre rights. But these objections are most unlikely to scupper the agreement. A provincial strike, called by some dissidents on July 11th, was scantly observed, reflecting broad support for the peace process. Moreover, ministers in the central government have also promised to amend the law if it is seen to have failed to satisfy the demands of most Acehnese.

A more pressing threat to Aceh's prospective stability has been posed by a spate of crime, including five murders, this month. Analysts say this may indicate disgruntlement among many low-level ex-GAM members, in particular over the failure of government peace-making incentives to reach them. The government sent half the sum earmarked for ex-militants to GAM's district leaders. But it has withheld the rest until those leaders submit lists of recipients' names. These lists have yet to be sent; some former fighters are turning to crime to survive. Compounding the dissatisfaction with the scheme is more general unhappiness with the pace of rebuilding the ruins left by the December 2004 tsunami, which devastated most of Aceh's coastal communities. Still, without the disaster, it is unlikely that the government and militants would have made peace.

There are also fears over what may happen after a European Union-led peace monitoring mission leaves Aceh in September. The EU group has done well to maintain relative tranquillity, and has moderated various local disputes competently. But it has failed to establish a local successor ahead of its departure. Unless it finds an appropriate body soon, there is a real danger that all its good work will start to unravel towards the end of the year.

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Australia

Heading for the divorce courts

Jul 13th 2006 | SYDNEY
From The Economist print edition

The row between prime minister and treasurer explodes onto the front pages

Get article background

THE political partnership between John Howard, Australia's prime minister, and Peter Costello, the treasurer (finance minister), has been possibly the most successful the country has seen. A robust economy and stable government, after ten years in power, is a record most administrations around the world could only envy. Like some outwardly successful marriages, though, tensions have never been far beneath the surface. On July 10th, they exploded into an ugly public display, as the two men jostled for power in the Liberal Party, the senior partner in the conservative coalition. Mr Costello in effect called his boss a liar, leading Mr Howard to accuse Mr Costello of “indulging in hubris and arrogance”. The row has rocked the government, and incited fears among its members that its days of apparent serenity are over.

Mr Costello, who turns 49 in August, has never hidden his ambition to take over the Liberal leadership from Mr Howard, who will be 67 on July 26th. Mr Howard himself set the succession question bubbling when he mused publicly six years ago that he would consider his future when he turned 64. The wrangle with Mr Costello followed a press revelation on July 9th about a private meeting between the pair in late 1994. Mr Howard was said to have given an undertaking then that if he became prime minister (as he did in 1996), he would serve one-and-a-half terms then hand over to Mr Costello. He is now serving his fourth.

Mr Costello endorsed the account. “That is what happened and people are entitled to know. I took him at his word,” he said. Mr Howard avoided the detail, saying instead that no deal had been done. Ian McLachlan, a senior Liberal Party figure, witnessed the 1994 meeting. This week, he released a note of it he had scrawled at the time. It confirmed Mr Costello's version.

As a proven election winner, Mr Howard still has the support of most Liberal parliamentarians. But this unprecedented showdown with his frustrated heir apparent has shaken his control. Mr Howard now has a choice. He could declare that he plans to fight the election due in 2007 as leader, and risk Mr Costello challenging him. Or he could name a time for what Mr Costello calls a smooth transition of leadership before the election, something he seems disinclined to do, especially under pressure. If Mr Howard continues to say nothing, more damaging ructions are likely.

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Uzbekistan

In the chiller

Jul 13th 2006 | TASHKENT
From The Economist print edition

Still looking to China and Russia for help, Uzbekistan gets more miserable

GONE are the days when small groups of protesters from the countryside gathered in Uzbekistan's capital, Tashkent, silently clutching placards, or photographs of a bloodied victim of police abuse. A brief alliance with the United States, when President Islam Karimov provided an air base to help American operations in Afghanistan after September 11th 2001, led to some concessions towards openness. They are now a distant memory.

Not much fun to be had in Tashkent

No demonstrations have taken place since security forces shot dead hundreds of mainly unarmed protesters in the eastern border city of Andijan in May 2005. Mr Karimov ordered the American base shut, and turned his back on Western criticism. The European Union imposed limited sanctions last year.

The Uzbek dictator has sought friendship elsewhere, among those who keep America at arm's length. At a meeting last month of the Shanghai Co-operation Organisation, a Central Asian grouping led by China and Russia, Mr Karimov railed that outsiders (ie, America) were sowing discord in the region. Visiting Belarus the following week, Mr Karimov said that Uzbekistan would rejoin a Russia-led club of former Soviet states known as the Collective Security Treaty Organisation.

At home, the defence ministry is being purged of those once friendly to America. Last month a senior official was sentenced to 15 years in jail for spying, while Kadyr Gulyamov, who last November was sacked as the country's first civilian defence minister, is now said by relatives to be on trial in a closed military court, charged with “economic” crimes to do with the air base. Mr Gulyamov's fall was, it is said, sealed by letters of support from Donald Rumsfeld, America's defence secretary, as well as by rumours that he was contemplating running in a presidential election due next year.

The purge spreads farther. A dozen human-rights activists have been jailed on trumped-up charges. The authorities have kicked out American aid groups, such as Counterpart International, which was delivering medical supplies and improving water, as well as Internews, which trains journalists in impartial reporting, and Freedom House, which teaches civic rights. They have also closed hundreds of Uzbek NGOs receiving Western money. These range from a youth organisation that taught army conscripts to use condoms to a beekeepers' association in the eastern province of Fergana. Some 500 members who

take their hives across the border in early summer to Kyrgyzstan's cooler mountains had been learning the letter of the law to counter the border guards' demands for bribes. Fostering even these kinds of ties with Kyrgyzstan is tantamount to subversion: Uzbekistan accuses the Kyrgyz authorities of involvement in last year's Andijan unrest.

Mr Karimov, who at 68 has ruled the country for 17 years, presumably thinks he is sitting fairly comfortably. Prices for Uzbekistan's main exports, cotton and gold, are high, while China and Russia are eager investors—Russia's Gazprom is developing gas fields in western Uzbekistan to meet European demand. Still, despite the open chumminess between Mr Karimov and Vladimir Putin, Russia's president, a Western diplomat suspects underlying tensions, for instance over gas sales and trade.

Such deepening isolation is doing Uzbekistan no good. Mr Karimov has destroyed much of the opposition, notably the Sunshine Uzbekistan coalition. In March its leader, Sanjar Umarov, was sentenced to nearly eight years in a remote jail, and his relatives were barred from visiting him. His lawyer had earlier found him in his cell, naked and incoherent. “This country has become a black hole, politically,” says Nigora Hidoyatova, one of the coalition's few leaders still able to speak out.

On Tashkent's streets, economic and social distress is barely concealed. In the red-light district, women are constantly arriving from outlying regions. They cannot get the registration they need to stay legally in the city, but they are prepared to risk police harassment to escape poverty. Conditions on Uzbekistan's state-run cotton farms amount to virtual slavery, according to the International Crisis Group, a think-tank. Many other prostitutes are deaf-mutes, recruited from state orphanages. The “Mama Roza”, or manager, of one group of prostitutes is in no doubt that the cause of the malaise lies with the government. “Let them be ashamed in Europe of our Uzbekistan,” she says.

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Israel, Palestine and Lebanon

The crisis widens

Jul 13th 2006 | BEIRUT AND JERUSALEM
From The Economist print edition

Getty Images

The capture of two Israeli soldiers by Hizbullah militants on the border with Lebanon has made an already dangerous crisis even more frightening

A MONTH ago, a spokesman for Lebanon's Islamist party, Hizbullah, on being asked how many Lebanese there were in Israel's jails, was unable to name the figure. But now the Shia militants who control southern Lebanon are hugely exercised about the issue. “Fulfilling its pledge to liberate the prisoners and detainees” in Israel, Hizbullah on July 12th attacked an Israeli army patrol by the border, killing three soldiers and taking two hostage. Five more died in a tank that hit a mine, after the Israeli army crossed the border in a vain rescue attempt.

In response, Israel bombed targets across Lebanon, including Beirut airport and Hizbullah's radio station in the Lebanese capital itself, and blockaded Lebanon's ports. Lebanese sources said that 48 Lebanese civilians had been killed. Meanwhile, Hizbullah rocketed Israel's northern border region. It is the biggest clash since Israel ended its 18-year occupation of south Lebanon six years ago.

Hizbullah's timing is no accident. Since Palestinian militants snatched an Israeli soldier near Gaza at the end of June, Israel has been gradually ratcheting up a military campaign in Gaza aimed at freeing him and stopping Palestinians from firing home-made rockets into Israel. It has not yet achieved either goal, but has killed at least 65 Palestinians, many of them civilians. This week it obliterated the Palestinian foreign ministry.

This adds pressure on the Palestinians' recently elected Hamas government, which is being strangled by a world economic boycott. Israel arrested many of its leaders a fortnight ago. The fiercely anti-Israel Hizbullah sympathises strongly with Hamas; it is closely tied to the government of Syria, where Hamas's exiled leader, Khaled Meshal, resides; and both groups enjoy support from Iran. Though Hassan Nasrallah, Hizbullah's leader, said that this week's raid had nothing to do with events in Gaza, it looks designed to take pressure off Hamas by showing Israel that its actions in Gaza have more than local consequences, and to force Israel into a dangerous escalation on two fronts.

For Hizbullah, that is a big gamble. It can count on the support of five ministers, a third of Lebanon's government, thanks to the backing of Shia Muslims, Lebanon's largest religious group, and to some astute political deals. This, along with support from Syria and Iran, has allowed it to ignore calls for its disarmament. But since Israel left, the Lebanese have got used to a rare peace and to a reviving

economy. While Shias are celebrating the nabbing of Israeli soldiers, most other Lebanese are gloomy. Hizbullah could now face a challenge to its hegemony in the south of the country. Lebanon's government will tread a fine line between appeasing the Shias and preventing a new conflict with Israel.

Hamas, too, is in trouble. Cracks have opened in its leadership, which is shared by Mr Meshal in Damascus, the government in the occupied territories and prisoners in Israel. Mr Meshal, who has most influence over Hamas's military wing, is struggling to assert his supremacy by taking the hardest line on the Gaza hostage.

But the risk for Israel is no smaller: that it will get dragged into a debilitating and open-ended campaign to free its soldiers. The Gaza operation has been billed as a once-and-for-all blow against the militants after months of rocket fire; though the crude weapons have killed only eight people since the start of the second *intifada* in 2000, the anger of Israelis who live within their short range is a constant thorn in the government's side. Apart from one statement, later retracted, Israel has said it will not swap the hostage in Gaza for prisoners, as Hamas is demanding; it cannot but take a similarly fierce line with Hizbullah. Ehud Olmert, the prime minister, called the raid “an act of war” and talked of “restrained” but “very painful” consequences for both Lebanon and Syria.

It is a pattern that is dogging Israel more and more. Its early wars were short, sharp affairs to beat off or deter massive military threats to its existence. Now the same doctrine of deterrence is forcing it to fight long, debilitating campaigns over a few soldiers. It has swapped hundreds of prisoners for a single soldier in the past, but fears this will encourage new kidnaps.

Probably, says one Israeli security source, those involved in planning Israel's Gaza operation “understand that the soldier won't be released except by a deal”, though they will try to arrange a delayed release of prisoners to make it seem to Israelis less like a direct swap. The point of the assault on Gaza, rather, is “to reduce the cost of a prisoner exchange” and to force Hamas to call a ceasefire in return for some calm. Egypt's president, Hosni Mubarak, blamed “other parties”—heavily hinting at Syria under Bashar Assad—for sabotaging a deal that Egypt was mediating.

At least in Gaza, which Israel has under its thumb, the captive soldier is unlikely to be moved. The hostages in Lebanon could easily be spirited away to Syria, or even Iran. Israel failed to strike a deal over Ron Arad, an airman captured in Lebanon in 1986. Israel's goal will be to flex its muscles in Lebanon without starting a war, and to put on enough pressure to make Hizbullah think twice about keeping the hostages, exporting them, or taking any more.

Yet because of Lebanon's finely balanced power structure, such pressure may have more chance of success than in Gaza, where power is more fragmentary. So far, there is little sign that Hamas is losing popular support. But, even if it makes the militants give up their captive, it may lack the authority over all the groups to make a ceasefire hold. Meanwhile, as Lebanon is dragged into the fray, calls for international mediation are sure to get louder.

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Iraq

Yes, it could get even worse

Jul 13th 2006 | BASRA
From The Economist print edition

Wanton sectarian violence threatens all-out civil war

BAD as things are, they can always get a lot worse. That, it seems, was the grim message on July 9th, when a group of Shia gunmen, said to be members of the Mahdi Army militia loyal to a firebrand clergyman, Muqtada al-Sadr, briefly took over a mainly Sunni part of Baghdad's Jihad district and massacred at least 40 people.

In the capital's sulphurous atmosphere of growing sectarian hatred, it is always hard to sift rumour from fact. Some Sadrists said afterwards that their militiamen were gunning for known extremists who had been responsible for sectarian killings of Shias. But it seems more likely that they simply tried to kill as many Sunnis as they could. Motorists, it was reliably reported, were pulled out of their cars at fake police checkpoints; along with passers-by with Sunni given names or tribal names, they were led into alleys and shot.

Such large death tolls in single episodes, especially in the wake of suicide bombings, have become distressingly common in Iraq. But this kind of massacre, when one side seizes control of the other's area and kills at leisure, reminiscent of civil wars in Lebanon or Algeria, has so far been much rarer. The more usual method of attack is to bomb the other side's mosque or to waylay groups of workers on the roads; insurgents particularly seek out army or police recruits congregating near barracks or travelling to work. This time, the Shia militiamen may have been incensed by a car bomb that Sunni insurgents set off near a Shia mosque in the area. In any event, the exceptional violence of this latest act of sectarian revenge could, if it triggers the usual tit-for-tat, dispatch Iraq towards an even bloodier—and even less containable—pitch of communal mayhem.

Iraq's elected leaders, who have hitherto tended to trade blame for such outrages in a kneejerk manner, may now have realised that they must do whatever they can to stop the killing spiralling out of control. The Iraqi Consensus Front, the largest Sunni-led block in parliament, with 44 of the chamber's 275 seats, said this week that it would end the legislative boycott it called a fortnight ago after one of its MPs, Tayseer al-Mashhadani, was abducted, probably by yet another group of Shia militiamen. At the same time, Mr Sadr, despite strong suspicions that his men were responsible for the massacre, has called for national unity; he does so quite often, but many of his adherents, in their far-flung and loosely-controlled network, often seem to pay little heed to such appeals for restraint.

The prime minister, Nuri al-Maliki, who took office less than two months ago, is set to take new measures. Reining in militias from his own Shia community is his single biggest immediate challenge; letting them get away with murder is the single biggest obstacle to drawing Sunni Arabs into peaceful politics and away from the insurgency. After Ms Mashhadani's abduction, Mr Maliki appears to have prodded Iraq's fledgling security forces into taking action against some groups of Shia militiamen, staging a number of raids against radical Shia leaders and engaging in at least two fierce firefights in the past week which left dozens of gunmen dead.

Can he tackle the militias?

But Mr Maliki cannot afford to take on groups like Mr Sadr's Mahdi Army in their entirety. He says that the solution is still to integrate them into the Iraqi army. But he may be able to target the factions on the fringe of the Sadrist movement who do disproportionate damage to Sunni-Shia relations. So far, these raids have not led to wider confrontations between government forces and the militias, which suggests that Sadrist leaders may be working behind the scenes to isolate their most extreme followers. Following the alleged rape and murder of a young woman by an American soldier, Mr Maliki's ministers are also

courting Sunni opinion by calling for the legal immunity enjoyed by foreign troops to be lifted, though the Americans are pretty certain to refuse.

All this leaves the “national reconciliation initiative”, unveiled by Mr Maliki only two weeks ago, struggling to avoid becoming an instant failure. Some ministers say that up to 20 insurgent groups have contacted the government, though it is not clear how active or powerful any of them are. A list of 41 most-wanted Iraqis, recently issued by the government, portrays the insurgency as driven mainly by former members of Saddam Hussein's regime, such as his former intelligence chief, Izzat Ibrahim al-Douri, in top spot. It is unthinkable that Mr Maliki would seek to negotiate with such people.

Still, his government, unlike that of his predecessor, Ibrahim al-Jaafari, does seem to be exploring every avenue in an effort to stem the violence. But if this week's wanton sectarian mayhem becomes the norm, the new government, which has representatives of all the main communities, could fall apart. In the past, the country's most influential Shia clergyman, Grand Ayatollah Ali al-Sistani, has managed to persuade Shia leaders not to encourage their militias to wreak wholesale sectarian revenge against Sunnis after outrages such as the bombings of Shia mosques. But his words may, of late, be falling on less obedient ears. Already, there is a kind of civil war; it could yet become no-holds-barred.

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Morocco

Making a hash of it

Jul 13th 2006 | MECHKRALLA, THE RIF
From The Economist print edition

Why it is hard to stop Moroccans growing a lucrative crop

ONCE you leave the tarmac road, the hillside hamlet of Mechkralla can be reached only after an arduous three-hour trek up a mule track, itself partly paid for by the European Union to encourage tourism in Morocco's northern mountain range, the Rif. Almost as soon as the main roads and towns are out of sight, the wild, rocky landscape turns into a patchwork of verdant cannabis fields interspersed with golden wheat and hot-pink oleander bushes. Along the way, women with bright striped sashes and straw hats are harvesting the tall seven-leafed plants.

The Rif has hundreds of villages like Mechkralla, virtually all surviving on the growth of this illegal crop whose resin, extracted from cannabis pollen, is turned into hashish. According to the United Nations, the region exports 1,000 tonnes a year, providing 80% of European hash-smokers' needs, and nearly one-third of the world's.

Hamed, a blissful-looking farmer who smokes the dried buds in the traditional way, mixing them with coarse tobacco in a long reed pipe, sells a kilo of hash for 3,000 dirhams ($348). By the time it reaches Paris or London, its value may multiply by ten. If Hamed grew wheat instead, his modest income would fall several times over.

Under the French protectorate, cannabis cultivation was eradicated in most of Morocco. But the Rif fell under nominal Spanish control and, even after independence in 1956, it had a dispensation to grow the crop but not to sell it in on a large scale. However, after the late King Hassan II quashed a rebellion in 1958 when still crown prince, the Rif fell into disfavour. Hassan refused to set foot there during his 38-year reign, a period when the Rif exported two main things: migrant workers escaping extreme poverty—and hashish.

One of Muhammad VI's first acts after succeeding his father seven years ago was to end that ostracism with a long state visit to the Rif. Under pressure from America and the European Union, his government launched a half-hearted war on drugs. Since 2004, when it finally banned cultivation, it has pushed cannabis-growing into the Rif's hinterland. Early this month, police burnt cannabis fields around Larache, on the Rif's Atlantic edge. New roads are being built to make cultivation more conspicuous and to encourage farmers to grow other plants, such as olive or almond trees. But they take years to bear fruit and bring in a lot less cash. So the government is simply pushing cultivation out of sight.

A liberal weekly, *Tel Quel*, published in French in Casablanca, is campaigning to legalise hash. Its editor, Ahmed Ben Chemsi, calculates from official figures on the sale of loose tobacco and rolling paper that Moroccans, who number 33m, smoke a good 1.1 billion joints a year—ie, about 60 joints a year for every adult. Legalising it, he says, would fill state coffers, bring tourists to the neglected region and reduce corruption. “How can it be illegal when so many people do it?” he says. “You can't criminalise such a large part of society.”

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Somalia

The rising fear of a war of proxies

Jul 13th 2006 | BAIDOA
From The Economist print edition

The crisis in Somalia drags on. Outsiders can help—or hinder

Get article background

AP

IT IS only a month since Islamist militias, operating under an umbrella calling itself the Council of Islamic Courts, crushed a clutch of CIA-backed warlords to take control of most of Mogadishu, Somalia's ravaged capital. A lot has changed since then. Early hope among Somalia-watchers has fast given way, once again, to fear. Both the Islamists and the feeble, internationally recognised transitional government, ensconced to the west in the dusty town of Baidoa, have become more strident. Other nearby countries, particularly Ethiopia, have become more meddlesome. A proxy war is brewing that could mess up the entire region.

The Islamists are on the front foot. They have surged out of Mogadishu, ignoring a flimsy ceasefire they signed last month with the transitional government, seizing one district after another and shredding the few who dared engage them in battle. Moderate Islamists appear to have been shoved aside by radicals keen to set up a conservative Islamist state, preferably one that takes in the Somali-inhabited swathes of neighbouring Kenya and Ethiopia.

It is still too soon to talk of a new Taliban, but there has been a slide into puritan thuggery recently, epitomised by the flogging with electric cables of a pop group, the Mogadishu Stars, for playing at a wedding. Statements of intent are becoming bolder and uglier. A Mogadishu cleric openly insists that anyone not praying five times a day should be put to death.

The main worry, for outsiders at least, is terrorism. No one knows how many al-Qaeda people, if any, are hiding in Mogadishu. Osama bin Laden apparently thinks there are a few; he recently called for Somalia to become a new battleground against America. That was a miscalculation. The radicals, who lean more towards the Muslim Brotherhood and Somali nationalism than the global *jihad* of al-Qaeda, distanced themselves from the statement and from Mr bin Laden. Still, the window of opportunity for making Mogadishu a bit safer for foreigners (including aid agencies) seems already to have closed. Arab fighters have been filmed riding around Mogadishu in armoured Jeeps.

The transitional government has not helped by likening one of the top Islamist leaders, Sheikh Hassan Dahir Aweys, to Mr bin Laden. Moreover, to the dismay of many Somalis, it has turned to Ethiopia, which most Somalis loathe, to guarantee its security. Hundreds of Ethiopian troops may already have entered Somalia from the west. Baidoa's airstrip is being widened to take Ethiopian military aircraft.

For the moment, the transitional government is unwilling to share power with the Islamists. In truth, there is not much to share. The parliament meets in an abandoned warehouse at the edge of Baidoa. It is a sorry looking place: a few chairs, a strip light, some banners on the wall advertising mobile-phone operators and money-lenders, and an orchestra in bright green outfits which now and again belts out old Italian marching tunes.

The United Nations, the European Union and assorted governments, including those of Italy, Britain and Sweden, pay for the parliament and the largely imaginary institutions around it. The United States has not been much of a supporter, though some in Baidoa think that might change if they stood up to the Islamists. A handful of foreign advisers and diplomats turn up at parliamentary sessions. Little gets said,

even less decided. The main drama, aside from the orchestra, is the arrival of the president, Abdullahi Yusuf. His presidential guard is better turned out than the buildings it is meant to protect. Its desert camouflage uniforms are new, maybe a gift from Ethiopia, as are some AK-47s and heavy machine-guns.

Outsiders could tip the balance towards war or peace. America, with a strong military and intelligence presence in Djibouti, will find it hard to tolerate an Islamist regime in Somalia headed by Mr Aweys or his friends, some of whom, it says, helped al-Qaeda in the past.

Ethiopia is even more allergic to the Islamists. It is worried about security on its borders and the potential radicalisation of its own Muslims. It may also see a fight in Somalia as a useful distraction from unrest at home. Ethiopia's prime minister, Meles Zenawi, denies his country has troops inside Somalia and instead, without showing any evidence, accuses Mr Aweys of having planted bombs in Addis Ababa, Ethiopia's capital, earlier this year.

Eritrea is a bit player, but a crafty one. It continues to ship arms to the Islamists in the hope of pulling Ethiopian troops away from its own disputed border. Mr Yusuf, Somalia's hapless president, is keen to lift an international arms embargo and bring in peacekeepers. The African Union (AU) backs him, but letting in foreign troops, in the first instance from Sudan and Uganda, may stir conflict as much as resolve it. Instead, the UN has tentatively suggested training up the Somali army and police.

There is still a chance that peace may prevail. Ordinary Somalis are exhausted by years of fighting; no government has ruled the whole of Somalia in peace since the coup against its long-time leader, Siad Barre, in 1991. The country is in bits. Puntland, to the north-east, is autonomous. Somaliland, to the north, has a functioning government that would love to secede, an idea that both the Islamists and Mr Yusuf's transitional government reject but which the AU now seems to back.

America would like to make up for its miscalculation in backing the warlords by working more closely with international bodies and the AU. Mogadishu's powerful businessmen, who backed the Islamists out of commercial self-interest rather than piety, could act as a brake on warmongers and overzealous Islamist enforcers.

The solution is probably power-sharing between the Islamists and the transitional government. That means the two sides sitting down together, as they promised to do later this month. The Islamists will have to be offered a lot of power. In return, they would have to agree to share revenue from Mogadishu's airports and port. Diplomats who have met Mr Aweys say that he is open to a bargain.

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South Africa's media

Watchdog or cheerleader?

Jul 13th 2006 | JOHANNESBURG
From The Economist print edition

The post-apartheid state broadcaster is caught up in controversy all over again

THE South African Broadcasting Corporation (SABC) has been making almost as much news as it reports. The state television and radio body has been attacked for stopping a documentary on President Thabo Mbeki just before it was due to air. Then came allegations that some commentators have been blacklisted for being too critical of the government. And while the SABC was being accused of being too cosy with those in power, Jacob Zuma, the former vice-president who has been acquitted of rape but still faces trial for corruption, has complained of trial by media and has issued a flurry of lawsuits against newspapers and radio stations.

Dali Mpofu, the SABC's boss, says that the public broadcaster is the victim of “an orchestrated campaign”. The SABC, he adds, will never succumb to pressure, whether it is “orchestrated from the political left, the centre or, as in this case, the right, which in South Africa is euphemistically and incorrectly referred to as liberal.” That was a dig at the opposition Democratic Alliance. Mr Mpofu says the documentary on Mr Mbeki, commissioned as part of a hard-hitting new series of profiles, was spiked because it lacked balance and, according to in-house and independent lawyers, was defamatory. He says the producers were given ample opportunity to make changes but failed to do so. Editorial independence, he added, is a basic value of public broadcasting; the SABC is fully committed to it. But the documentary producers said they were shocked to have their work withdrawn at the last minute.

Allegations of blacklisting were first reported in the *Sowetan*, a daily newspaper. When the public broadcaster's spokesman denied the accusations on a live radio show, the host, a respected and seasoned SABC journalist, retorted that he had had first-hand experience of pressure to exclude specific commentators. The corporation has asked Zwelakhe Sisulu, a former SABC boss, and Gilbert Marcus, a media lawyer, to look into the allegations.

The incidents have revived an old debate about the independence of the public broadcaster, which is still hugely influential. Once a mouthpiece for apartheid governments, it is now accused of echoing the ruling African National Congress (ANC). A steady exodus of senior staff and an apparent rise in the number of political appointees has reheated the controversy.

In a recent article for a Harvard publication, Pippa Green, who headed SABC radio news until last year, paints a worrying picture. She describes a clash of culture between editors and reporters committed to honest journalism, and managers who see a quite different role for public broadcasting. She accuses SABC's regional managers, who “hanker for cosier relations with local political and business leaders”, of interfering with editorial decisions, and says a “big chief” culture exists in the SABC. According to Ms Green, it is sometimes run as a professional public news service, but in other instances has become “a political grazing ground for the ruling party faithful”. Despite many good changes at the SABC since apartheid ended, it is still scared of ruffling government feathers.

The government and its supporters, on the other hand, often accuse private newspapers and radio stations of being obsessively critical and at times unprofessional. The constitution entrenches the independence of the media. Newspapers do criticise officials and sniff out murky oil and arms deals, or wrongdoing such as fraud over MPs' travel expenses. The ANC's leaders are often irked by leaks and anonymous sources from within the party's own ranks. Mr Zuma, who says he has been unfairly treated by journalists and cartoonists, is suing various publications for over 60m rand ($8.4m) in damages.

The recent brouhaha points up the awkward choices the media face in a young democracy. For sure, the ANC is prickly. It often denounces critics as racist or against democracy. Under apartheid, many independent newspapers, though often hounded, saw their job as opposing the government. As the ANC

was elected to remedy past wrongs, it expects the media, broadly speaking, to support it; if not, by implication, they cannot expect to be treated kindly.

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France's president

The man who deserves a red card

Jul 13th 2006 | PARIS
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It is plain that Jacques Chirac has wasted his 11 years as president

Get article background

AS JACQUES CHIRAC opens the Elysée Palace on July 14th, for his annual garden party, it is surely clear that this Bastille Day will be his last as president. Although the 73-year-old veteran has said he will decide whether to run again for next spring's presidential election only early in 2007, it now looks all but impossible. His government is paralysed, his prime minister, Dominique de Villepin, is unloved, and the French have had enough.

A sense of *fin de règne* was confirmed last weekend on the football pitch. Zinédine Zidane, the captain of the French team, was sent off during the World Cup final, which Italy won on a penalty shoot-out. It was a painfully fitting metaphor for the country's general malaise. The victorious multi-ethnic French champions of 1998 appeared, in those heady days of economic growth and new dynamism, to embody a fresh national spirit. This time, hopes of recapturing that glory were vested in Mr Zidane, the working-class son of Algerian immigrants. De Gaulle-like, he came out of retirement to lead the team. In the end, provoked by an insult, he got a red card for head-butting an Italian player, leaving the field in disgrace and the French without their promised saviour.

A similar yearning for somebody to rescue France from its melancholy hangs in the political air. After 11 years in the presidency, Mr Chirac has come to embody the country's political inability to renew itself. In politics for 41 years, he is the only serving politician who has belonged to governments under every fifth-republic president since de Gaulle. His popularity has collapsed. According to TNS Sofrès, a pollster, Mr Chirac is now the most unpopular French president since its polling began in 1978. *Libération* put it well this week: “For a month, France has been dreaming with Zidane. This morning, it wakes up to Chirac.”

It is a measure of their despondency that the French have begun to write the president's political obituary. Franz-Olivier Giesbert's trenchant account of Mr Chirac's past 20 years, “La Tragédie du Président”, has been a bestseller for months. The author is merciless: “By cowardice as much as by blindness, he persists in pursuing policies which, for over 20 years, have been leading the country to ruin.” A satirical documentary, “Dans la Peau de Jacques Chirac”, is showing in cinemas. *Le Monde* recently called on the president to resign.

Certainly, the record of the past decade has been meagre. Mr Chirac was elected in 1995 on promises to cut taxes, to curb unemployment and to “mend the social fracture”. Yet, under his watch, France has slipped out of the world's top five economies. Its public debt has swollen from 55% of GDP to 66%; unemployment has never dropped below 8%. At the start of Mr Chirac's reign in 1995, France was paralysed by strikes against reforms, and governed by an imperious, unloved prime minister, Alain Juppé. Now, towards its end, France has seen 1m-3m people on the streets in a student-led protest against labour-market reforms, and is governed by the imperious, unloved Mr de Villepin. A president who promoted the construction of a strong Europe, to counter-balance America in a multi-polar world, failed to persuade his own people to vote for its new constitution in last year's referendum.

The disappointment is bitter. Some had hoped that the man who, as prime minister in the 1980s, launched privatisation and abolished the wealth tax, would rediscover his liberalising zeal. “The French machine no longer works,” he declared in his 1995 election campaign. Yet, after a bold but failed attempt that year, Mr Chirac gave up on anything more ambitious than little *réformettes*, such as those of pensions and health. Income-tax cuts have fallen far short of his pledges. These days, indeed, Mr Chirac blends leftish anti-liberalism with an ardent defence of France's traditional “social model” against those, including his interior minister, Nicolas Sarkozy, who argue that after 20 years of stagnation it might need reinventing.

As for mending the social fracture, Mr Chirac did his best this week to lean once more on the multiracial French football team as a lesson in integration. “France”, he told the players, whom he hosted for lunch, “is stronger when it is brought together in its diversity.” Mr Chirac has, commendably, made a point of trying to stamp out racism and anti-Semitism on his watch. He was the first president to accept the official responsibility of the French state for the deportation of Jews from Vichy France during the occupation. This week, he honoured the 100th anniversary of the rehabilitation of Alfred Dreyfus, a French Jewish officer wrongly condemned for treason. And he has long supported Turkey's entry into the European Union, against the wishes of voters as well as most of his party.

Yet the riots that swept through France's *banlieues* last autumn punctured any lingering illusions that the multi-ethnic country was truly at ease with itself—or that integration on the football field could be easily replicated off it. This is a country, after all, where the far-right Jean-Marie Le Pen reached the presidential run-off in 2002. The National Front leader remains a threat. During the World Cup, he declared that “France does not totally recognise itself” in its mostly-black team. Yet voter support has proved steady. If both Mr Chirac and Mr Sarkozy stood for the right in the first round next year, said a *Paris-Match* poll last week, Mr Chirac would score just 8%—and Mr Le Pen 12%.

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Italy and football

Blues' delight

Jul 13th 2006 | ROME
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The agony and the ecstasy of Italian football

AP

Hands on the trophy

HE MAY be lumbered with a nine-party coalition and a one-seat majority in the upper house of parliament. But Italy's prime minister, Romano Prodi, seems to have something that could yet offset these handicaps: luck. As he himself noted, Italy's win against France in the World Cup final on July 9th was as narrow as his own victory in the election in April. Tied 1-1 after extra time, the Italians won a penalty shoot-out when a Frenchman (who ironically plays for an Italian club, Juventus) hit the crossbar. That gave Italy's captain, Fabio Cannavaro, the trophy—and Mr Prodi a boost, politically and maybe even economically.

Analysts at ABN Amro, a Dutch bank, have estimated that a World Cup victory adds 0.7% to the winner's GDP, mostly through extra demand. Research by another bank, JPMorgan, has found that consumption in European countries that won the cup in recent decades rose afterwards by more than the EU average. Some analysts remain sceptical of a “World Cup effect”, arguing that it merely brings forward spending. But Mr Prodi's own finance minister, Tommaso Padoa-Schioppa, thinks Italy's win will have a positive effect “because it has an impact on confidence and signifies that ambitious goals are within our reach”.

Yet the benefits of Italy's victory could be offset by the loss of esteem it would suffer were it to use the triumph as an excuse for taking the easy way out of another challenge. Not the least remarkable aspect of Italy's success is that it was achieved against a background of spectacular footballing strife back home. Thirteen of the 23 members of the Italian squad in Germany play for clubs that are threatened with relegation over a match-fixing scandal. Most at risk is Juventus, a publicly quoted club that supplied five of the players (including Mr Cannavaro). It could be relegated from the first to the third division by a sports tribunal in Rome. The verdicts were expected to be handed down by the end of this week.

The justice minister, Clemente Mastella, had suggested that the national team's victory might earn the clubs a reprieve. Encouragingly, Mr Prodi would have none of it. His sports minister, Giovanna Melandri, branded the proposal “idiocy”. Just as importantly, some of the players themselves rejected the idea. Gennaro Gattuso, a midfielder who plays for AC Milan, the club owned by Silvio Berlusconi that could also be relegated, said: “Those who have committed offences ought to be punished.” That is a welcome new thought in Italy.

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German reforms

Coalition troubles

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First health care, now tax. But the government's zeal for reform is fading

THE party's over—and Germany has a hangover. Not because its football team did not win the World Cup. As hosts, Germans are proud of having shown the world that they are as fun-loving and welcoming as anybody else. Rather, it is Angela Merkel's grand coalition that is suffering. After a long honeymoon, her government is starting to look almost as paralysed and unpopular as the old one.

One sign of trouble emerged last week, when the government agreed on health-care reforms that do little to solve the system's problems. Far from decoupling health-care premiums from wages, which the Christian Democrats wanted, wage-related premiums will rise. Rather than cutting red tape, a new "health-care fund" will add a layer. And the reforms fail to inject much more competition into the system.

This week it was the turn of tax reform, when Peer Steinbrück, the Social Democrat finance minister, presented his plans for corporate tax. Most analysts say that the corporate-tax system needs a thorough overhaul. Rates are too high, despite several cuts; the average tax burden for companies is among the highest in Europe. This gives firms a big incentive to transfer profits to subsidiaries in lower-tax countries—or to move operations completely.

There are structural problems, too. Germany has two corporate levies, which explains the high overall rate. The normal federal tax on profits is 25%. But on top of it is added a German speciality called *Gewerbesteuer*, or trade tax (which is 14% on average). Introduced in the 19th century to finance municipal infrastructure, it still bears the mark of its origins: companies pay tax even on interest payments for long-term debt, meaning that they can be liable even if they make no profit.

Predictably, many firms have set up financing subsidiaries abroad. Equally predictably, finance ministers have long wanted to get rid of this tax, replacing it with something else. But the cities have always blocked such a move. In particular, the large cities that are home to many big companies worry that any other revenue source would produce a lot less money.

Yet Mr Steinbrück has now shelved any far-reaching reforms. They would be expensive and their financial effects would be hard to predict, making it tougher than ever to get the budget deficit down. What is more, the Social Democrats' left wing is against anything that looks like a tax break for companies. And municipalities still resist the idea of abolishing the trade tax.

To square the circle, Mr Steinbrück intends to turn the federal corporate tax into a second trade tax. He plans to cut rates by half, but—both to compensate for the shortfall and to make funnelling profits abroad harder—to widen its assessment base by not allowing such costs as interest and leasing payments to be offset. The average tax rate for companies would fall to 29%. But that is still above the European average. And an even bigger share of tax payments would now be independent of whether a firm makes a real profit.

Unsurprisingly, business lobbyists are up in arms. But Mr Steinbrück insists that this solution is the best he can come up with, given the political and financial constraints. One step that could endear him to smaller businesses that pay tax as individuals rather than as companies is the plan to give them tax breaks if they re-invest profits or use them to build up reserves. And as well as a lower corporate-tax rate, a lower capital-gains tax of between 25.5% and 30% may also encourage investors. Still, if Germany wants its corporate-tax system to be truly competitive, mere tinkering with the engine will not suffice. A thorough overhaul is needed.

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Poland's government

Twin problems

Jul 13th 2006 | WARSAW
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Poland is suffering from a bad image. Blame the Kaczynski brothers

Reuters

One of them is now prime minister

IT IS easy to argue that the Law and Justice party has done disappointingly little in the nine months since it won Poland's parliamentary and presidential elections. But in one respect it has done a lot: once a regional heavyweight, respected in America and around Europe, the country now attracts ridicule and condemnation.

The main culprit is the president, Lech Kaczynski. Chaotic organisation, poor staff and inexperience have led to a series of gaffes, rows and snubs. The latest was his withdrawal from a trilateral summit with France and Germany after a satirical article in a minor German daily. By insisting that the German government apologise, Mr Kaczynski cast doubt on his understanding of press freedom.

Another culprit is the right-wing League of Polish Families, one of two small parties in the ruling coalition. It attracts a thuggish fringe, deliberately conflates homosexuality with paedophilia, and has failed to shake off accusations of anti-Semitism. The Israeli ambassador refuses to meet its leader, Roman Giertych, who is deputy prime minister and also in charge of education. Mr Giertych's father, Maciej, a member of the European Parliament, recently made a speech praising Franco, Spain's fascist dictator, as a hero and statesman of a stature Europe is now sorely lacking.

Mr Kaczynski's identical twin brother Jaroslaw, who runs the Law and Justice party, is doing his bit too. This week he took over as prime minister from Kazimierz Marcinkiewicz, who was the country's most-trusted politician, and also proved himself a competent negotiator on Poland's behalf at European summits.

The switch was a big surprise. Mr Kaczynski argues that the government will be more stable if he is running it from the front rather than from the back seat, as before. By becoming prime minister, though, he is breaking an earlier pledge, when he argued that it would look odd to have the two top political positions in Poland occupied by identical twins.

Now the Kaczynski brothers (particularly Jaroslaw, who is the brainier and bossier one) are in full charge. Their priority is to press ahead with the moral regeneration of Poland, which implies fierce criticism of both its communist history and the sleaze and injustice of the past 15 years. In practical terms, that means tough anti-corruption measures and a purge of the public sector.

Much of this is welcome. Poland has been shackled by the influence-peddling of the old elite. The justice and interior ministries have been notably successful of late in putting more police on the streets and bringing more criminals to justice. The defence minister has closed down the lawless military intelligence service.

But this is only part of what is needed. There remains a huge need for reform in the public administration, such as tax collection. Shake-ups in pensions, welfare payments and farm subsidies are also long overdue, but they may be blocked by the two populist parties in the coalition. Mr Kaczynski has brought in a well-respected free-market economist, Stanislaw Kluza, as finance minister, after a previous incumbent, Zyta Gilowska, was forced out on (possibly trumped-up) spying charges. But the Kaczynski brothers still have a strong welfarist streak.

For now Poland's economy is booming and public finances are buoyant. Growth this year will be over 5%; inflation is the lowest in the European Union; unemployment is coming down. Foreign firms, including Toyota and Google, are eagerly eyeing up Poland. Much of the credit goes to Mr Marcinkiewicz, who wisely avoided picking fights with such Law and Justice bogeymen as the central bank, the European Commission and foreign investors. He will be a hard act to follow.

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Ukraine's government

Laugh or cry

Jul 13th 2006 | MOSCOW
From The Economist print edition

The orange circus and Ukraine's circular politics

“WE ARE forming a new political culture”, President Viktor Yushchenko told the people of Ukraine last week, “which will last for centuries.” Given recent events, that seems an optimistic timescale.

After the parliamentary election in March, it took three months for Mr Yushchenko's Our Ukraine party to form a coalition with the two other parties that had swept him into office in the “orange revolution” of 2004: the Socialists and a block led by Yulia Tymoshenko. The first orange coalition, in which Ms Tymoshenko was prime minister, collapsed last September; this one fell apart after just two weeks. The Rada, Ukraine's parliament, has since become a circus of fistfights and cat-calling.

The trouble started when the Socialists did a deal with the Communists and the Party of the Regions, the two other parties in parliament. With just enough seats to form its own majority, this new “anti-crisis coalition” proposed its own candidate for prime minister: Viktor Yanukovich, the Party of the Regions' leader, who was the loser of the 2004 presidential vote to Mr Yushchenko. “Everything will be all right with gas,” the pro-Russian Mr Yanukovich told a newspaper, referring to the dispute between the two countries. “I promise.” His party had blockaded the Rada, to prevent the orange team voting for Ms Tymoshenko as prime minister. After the Socialist defection, her party created its own havoc. Tent cities sprang up outside in support of various parties.

The official reason for the orange split was the Socialists' rejection of the coalition's candidate for speaker, Petro Poroshenko, a businessman and ally of the president. The objection was not unreasonable: it was the mutual loathing between Ms Tymoshenko and Mr Poroshenko that helped to make the first orange government unworkable. The unofficial reasons were said to include large amounts of money and the ambition of Oleksandr Moroz, leader of the Socialists, to be speaker himself. He was duly voted in last week. “Moroz is Judas!” cried his spurned allies. “The problem”, opined Mr Moroz, “is that certain individuals want to attain power at any price.” Ms Tymoshenko blew him sarcastic kisses.

What happens now is anyone's guess—though probably, in the end, it will be Mr Yushchenko's decision. Ms Tymoshenko, and some in Our Ukraine, say that Mr Moroz's betrayal broke parliamentary regulations, so everything that followed was illegitimate. They want the president to dissolve the Rada and hold a new election (in which Mr Moroz would be unlikely to do well). Mr Yushchenko could delay a decision on Mr Yanukovich's candidacy as prime minister long enough to permit this. The other option may be a grand coalition that takes in bits of the president's party as well as the Party of the Regions, drops the Communists and leaves Ms Tymoshenko's block in opposition—though that would probably mean finding a different prime minister to Mr Yanukovich.

There is still (just) a faint hope that some good will come from this farce. A new election might produce a more stable parliament. Or a grand coalition might ease the resentments of eastern Ukraine, which overwhelmingly backs Mr Yanukovich—though it is hard to see such a coalition lasting long. At least, says Hryhoriy Nemyria, Ms Tymoshenko's adviser, trying to be upbeat, there has been no violence—except within the Rada.

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Islam in Europe

Culture clash

Jul 13th 2006 | ISTANBUL
From The Economist print edition

Some new thinking on the future of European Islam

FOR people interested in Islam, Europe and history, Istanbul often feels like a time-warp in which different eras of history are being lived out at the same time. That feeling was strong earlier this month. In an elegant villa on a wooded estate on the Bosporus—German property since the days of the Kaiser's alliance with the Ottoman empire—some hard, practical discussions took place about the future of Muslims (most of them from Turkey) in Germany. At the same time, the British government—which was often frustrated during the first world war by the Germans' apparent ability to communicate with the Muslim soul—co-sponsored another, grander gathering in the city, where many Islamic luminaries assembled to discuss the future of European Islam.

Coming from many shades of Islamic thought, the luminaries agreed on a statement that praised Europe for its freedom of religion, urged European Muslims to be loyal and law-abiding citizens and condemned terrorism “in all its forms”. Since not all the participants were noted for their moderation, the final statement was a hard-won achievement.

At the German gathering, a well-chosen mixture of Islamist feminists from Turkey and prominent Muslims from Germany (converts as well as Turks) worked out various ways to improve the status of Muslim women in Germany. The British affair—co-organised by the Foreign Office, but originally dreamed up by Tony Blair—drew in a wider variety of Muslim activists and sheikhs, from Yusuf al-Qaradawi, a Qatar-based preacher whose broadcasts influence millions of Muslims, to Hamza Yusuf, a Californian teacher whose taped sermons are snapped up by the faithful in Cairo and Islamabad.

But some things have changed since the days of German orientalists such as Max von Oppenheim, who advised the Kaiser on how to turn the war against Britain, France and Russia into a *jihad*. In a globalising world where anybody (at least in the West) may convert to any religion, some of the most powerful voices in the debate about Islam are those of “white” converts.

Take Amina Erika Thiessen, an articulate lady who organises aerobics classes for modestly clad Muslim women in her native Cologne. As she explained in Istanbul, she tells Muslim women to stand up to their husbands if they force them, in the name of Islam, to stay at home: that is not, she insists, what Islam teaches. An equally feisty message was delivered by Hidayet Tuksal, a Turkish theologian who wants to change the “patriarchal language and codes” that Muslims wrongly see as an essential part of their faith.

At the British affair, a verbal bombshell was thrown by Abdal-Hakim Murad, a Cambridge don and respected Muslim scholar. In the middle of an otherwise cautious and impeccably Islamic address, he said that people who condone suicide bombings had no place in European countries. Although no names were mentioned, this was an unmistakable jibe at Mr Qaradawi, who says that suicide attacks in Israel are exempt from the usual Muslim strictures against killing oneself and harming civilians. Because Mr Murad is an accomplished scholar who has spent many years in Egypt and Saudi Arabia, nobody holds it against him that he was born Tim Winter, an English nonconformist.

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Charlemagne

The perils of project mania

Jul 13th 2006
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Europe is right to play technological catch-up with America, but not with big public projects

IN THE dying days of 2005, a Soyuz rocket blasted off from Baikonur, in Kazakhstan, carrying the first of what are intended to be 30 satellites. When it is operational in 2010, the Galileo system, run by the European Union and the European Space Agency, is meant to compete with America's Global Positioning System (GPS) for in-car navigation, air-traffic control and cargo tracking. Two months later, the European Commission president, José Manuel Barroso, unveiled a plan for a new European Institute of Technology (EIT). This is supposed to be Europe's answer to the Massachusetts Institute of Technology, a centre of academic excellence and generator of start-up companies. In April, President Jacques Chirac announced that the French and German governments would pour €600m ($750m) over five years into several high-tech projects, the costliest of which is Quaero ("I search" in Latin), an internet search engine intended to compete with (you guessed it) an American company: Google.

Almost by accident, Europe has begun a policy of shoring up its information-technology sector through a handful of large, publicly financed high-tech projects designed to catch up with America. This has happened before. Airbus was created with public money to break Boeing's grip on the civil-aircraft market. But the new projects have even bolder aims: to increase European competitiveness, improve the use of information technology and to create thousands of start-ups. There is no doubt that Europe needs a good kick-start in all these areas. It tends to be less good at exploiting IT use, which may explain why productivity growth has been flat, whereas America's has accelerated. On average, Europe spends a smaller share of GDP on research and development than America. Its universities are falling behind America's in many ways, including the numbers of software and computer engineers they produce.

But can big public projects solve such problems? Henning Kagermann, boss of SAP, one of the few European companies to dominate any IT business, says there is a case for public investment in research that companies will not do because it is too expensive or has too long a pay-back period. This was, after all, the argument used to justify America's investment in the internet and in GPS (the Pentagon owns the GPS satellites). But Europe's record of government investment in IT is dismal. Remember Minitel and Prestel, respectively the French and British online rivals to the internet? They are best forgotten. The case for putting taxpayers' money into IT projects that companies will not themselves finance might justify Europe's me-too satellite-navigation system. But internet search engines are different. Most R&D is done by companies, often small ones. The €90m that France and Germany are putting into Quaero is peanuts compared with Google's capital spending of around $1 billion a year.

America's investment in the internet has been repaid many times over in taxes collected from internet companies or the people who work in them. Europeans argue that the same thing will happen with their new projects. One study suggests that Galileo will create 140,000 jobs, and the EIT is supposed to spin off lots of new firms. But, partly because it would take too long for a new university to establish credibility and partly because EU governments all wanted it to be on their territory, the EIT will not have a campus that could become the centre of a high-tech cluster, as Stanford is for Silicon Valley. Instead, it will be a networked university, which may not attract the best professors and students and may replicate the work of existing universities. More generally, public investment in high-tech projects risks crowding out venture capitalists, may undermine entrepreneurial culture and risks directing money to a few favoured firms rather than spreading it across a thousand flowers.

Europeans make two economic arguments in response. First, as the head of development of Europe's main satellite-maker recently told the BBC, the EU provides competition to what would otherwise be American monopolies. This is demonstrated by Airbus, until recently a great European success story. It may also be applicable to Galileo. The GPS system is a monopoly: if anything goes wrong with it, consumers will have no alternative. But this thinking does not work in the case of Quaero. Google has many competitors, even if no big one is European.

The leapfrog gambit

Second, Europeans say that public investment will be justified by technological leapfrogging. Again, they have a partial point. GPS is accurate to within about 15 feet (five metres); fine for navigating a car but too imprecise for pedestrians. Galileo will be accurate to three feet. It can give you directions inside a building, and will turn your personal position into a commodity that can be used or abused (maybe a mixed blessing). Google can search the text of a billion documents but cannot yet search audio material or videos. Quaero will do so: it will process podcasts, television broadcasts, and the rest of the video and audio material that the internet now carries. But this technology is not unique to Quaero and it does not need public money to develop it. Several small firms are working with video-searching technology. The chances are that one day their products will be incorporated into commercial search engines.

It may seem churlish to criticise projects that seek to catch up with the world's market leader when Europe is struggling to improve its use of IT. But in 20 years' time, Europe will be competing with India and China at least as much as with America. And the continent's real problems lie in such things as a lack of entrepreneurial spirit, weak links between universities, business and government, an underdeveloped venture-capital industry, a cumbersome patent process and red tape that ties small companies in knots. Systemic changes are needed, not a clutch of high-tech projects that will barely touch these bigger worries—and may end up wasting a lot of public money.

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Award: Sophie Pedder

Jul 13th 2006
From The Economist print edition

Sophie Pedder, our Paris correspondent, has won the 2006 David Watt prize for her article on French anti-Americanism on December 24th 2005.

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Energy

Return to the atomic age

Jul 13th 2006
From The Economist print edition

AP

The government wants new nuclear-power plants. Will it get them?

Get article background

THE rehabilitation of nuclear power has been as fast as it has been remarkable. In 2003 the government's energy-policy review wrote off atomic power as too expensive. It argued that renewable energy was the way to keep the lights on and carbon emissions down. Yet barely a year later officials were hinting heavily that minds had changed—so heavily that, when Tony Blair announced a second energy review in November 2005, it was condemned by green campaigners as little more than an exercise to rubber-stamp a decision that had already been taken.

It was probably to dispel this notion that Mr Blair chose this week to launch his new review on a boat, bobbing up and down in front of an offshore wind farm in the Thames estuary. The review is careful to discuss tree-hugging policies such as extending the main subsidy for renewable energy and promising to help reduce demand. But few doubt that securing a new generation of nuclear-power plants remains the point of the exercise.

Three things, says the prime minister, have conspired to change his thinking. The first is a looming supply crunch. Nuclear power currently supplies a fifth of Britain's electricity. But the reactors are old and decrepit, and by 2023 only one will remain. New European environmental rules mean that many coal plants will close too. Left to its own devices, the market would fill the gap with stations fired by natural gas, which are cheap and quick to build. But Britain already gets a third of its electricity from gas. Replacing old coal and nuclear plants with gas-fired ones would boost that share to almost 60%, leading to an uncomfortable reliance on a single fuel source—and one that will increasingly need to be imported as North Sea production runs down.

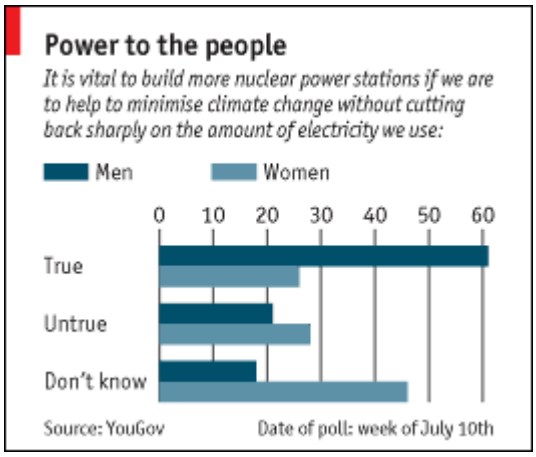
The second concern is climate change. Evidence that carbon emissions are hurting the environment has strengthened since 2003, and Britain is struggling to meet its green ambitions. The government admitted this year that it would miss its goal of cutting emissions by 20% by 2020. Lastly, Mr Blair believes that today's high oil and gas prices will persist, improving the economics of nuclear power.

All this will be music to the ears of the nuclear lobby, which has been making similar arguments for

years. They claim the newest reactors are cheaper to build than their subsidy-gobbling predecessors, and that the advent of the EU Emissions Trading Scheme (ETS)—a cap-and-trade system that assigns a price to carbon emissions—makes them even more attractive financial propositions. Fuel costs are low, and uranium can be bought from stable countries such as Canada and Australia.

But while Mr Blair may be convinced by such arguments, he needs to persuade investors—and the public—to back nuclear power too. Voters, at least, seem reasonably receptive. Surveys have shown public support rising over the past few years (although they disagree about the exact level). A YouGov poll for *The Economist* found more in favour of new nuclear plants than opposed, although there was a sharp divide between men and women, with the latter far less keen (see chart). The biggest worry was waste disposal, something that ministers hope to address in another report this month.

Persuading investors could prove harder. Nuclear-power plants are cheap to run but relatively expensive to build. That makes them a dicey proposition in a fast-moving energy market like Britain's, where changes in spot power prices can transform a profitable plant into a loss-making one overnight. Planning tangles make things even worse. The last nuclear plant to be built, at Sizewell, spent six years in a planning inquiry. Indeed, the economics are so tricky that other countries have resorted to straight subsidies (as in America) or else to complicated long-term financing deals involving big power-users (as in Finland, which is building Europe's first new nuclear plant for over a decade).



Yet Britain's ministers say that any new nuclear plants must make do without the vast amounts of public money they have consumed in the past. The review tries to make life easier for them in other ways. Planning will be streamlined and it will be harder for local residents to object to big power stations (nuclear or otherwise). New licensing rules will approve reactor designs for construction anywhere, rather than requiring approval for each individual plant. And ministers have promised to try to strengthen the carbon-trading market by prodding other European governments to extend and tighten the ETS.

It is this last measure that is the weakest, says Rob Gross, head of policy at the UK Energy Research Centre. “Power producers want a long-term, stable carbon price,” he says. “But the ETS can't provide that. The whole idea of a cap-and-trade scheme is that you fix quantity, not price.” Others question the government's ability to shape the system. “It must be news to the rest of Europe that Britain intends to reform the ETS by itself,” says Dieter Helm, of Oxford University. But there may be a back-up plan: the review hints at the intriguing possibility that some kind of national carbon pricing scheme applying only to Britain might be set up. (The Tories have also suggested this.)

Persuading the other political parties to support nuclear power will be the government's final challenge. “Investors have to know that such a long-term policy has the confidence of all the main political parties,” says Vincent de Rivaz, the boss of EDF, a power firm with nuclear ambitions. The Tories—who have been polishing their green credentials under David Cameron—grudgingly accept that new nuclear power may be necessary, although observers suspect their reluctance is overplayed. A bigger problem will be the Liberal Democrats, who remain hostile to nuclear power.

Despite these worries, people in the power industry seem confident. “I've said in the past that we were investors-in-waiting,” says Mr de Rivaz. “And the energy review is very encouraging.” David Porter, head of the Association of Electricity Producers, agrees: “We got about 90% of what we asked for,” he says. What they will do with it remains to be seen.

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Labour's loans

Too close for comfort

Jul 13th 2006
From The Economist print edition

The loans-for-peerages scandal takes on new life

THE arrest on July 12th of Lord Levy, Tony Blair's close friend and chief fund-raiser, for questioning in connection with the rumbling loans-for-honours scandal, was not news the prime minister would have wanted to hear as he prepared for his summer holiday. A lawyer for Lord Levy, who was released on bail after six hours of questioning, criticised the police for using their powers of arrest unnecessarily. “Lord Levy very vigorously denies any wrongdoing,” he said. “Lord Levy has not been charged with any offence and confidently expects not to be charged”.

Allegations by an Indian-food entrepreneur, Sir Gulam Noon, in a BBC interview this week triggered the flurry of activity from the police. Sir Gulam revealed that some months after he had reached agreement with Lord Levy to lend the Labour Party £250,000, he was told that the prime minister was nominating him for a peerage. The next day he filled in a standard form from the House of Lords appointments committee, which vets nominees. In it he declared the £250,000 and sent the form back to Downing Street to be passed to the commission.

Within 24 hours, Sir Gulam claims, he was telephoned by a “senior Labour Party figure” and told that the loan did not need to be declared. That figure, the BBC says, was Lord Levy. Sir Gulam later sent in the form again without mentioning the loan. When the appointments commission later learned of it through newspaper reports, it rejected his nomination along with several others.

Nothing in this account necessarily suggests that Lord Levy did anything illegal. The police have not proved that he assured Sir Gulam that his loan would lead to a peerage, which would be a flat breach of the law. If they did, Lord Levy would not be the only person in trouble. It would almost certainly be the end of the road for Mr Blair as well.

As *The Economist* went to press, John Yates, the policeman in charge of the investigation, was due to appear in private before the House of Commons public- administration committee, which suspended its own inquiry into the honours system while the police did their work. On July 13th the committee set out its own ideas on how to clean up the way political parties are financed.

Its main conclusion, other than that the system should be more transparent, is that honours should be separated from appointments to the Lords. “The impression of peerages being offered as inducements in kind rather than conferred in the expectation of future participation in the legislature is damaging,” the committee said. No argument there.

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The NatWest Three

America's long shadow

Jul 13th 2006
From The Economist print edition

Tony Blair is accused of giving in to America. Again

AFP

Mr Mulgrew is off against his will

IN 1850, defending his decision to blockade Greece after an Athenian mob had burned down the home of a British citizen, the foreign secretary, Viscount Palmerston, told the House of Commons: “As the Roman, in days of old, held himself free from indignity when he could say *Civis Romanus Sum*, so also a British subject, in whatever land he may be, shall feel confident that the watchful eye and the strong arm of England will protect him against injustice and wrong.” Times have changed.

As *The Economist* went to press, a trio of British former bankers known as the “NatWest Three” were on a plane to Houston to face fraud charges relating the collapse of the energy-trading firm, Enron. The only comfort Tony Blair was prepared to offer them was the hope that they would be allowed bail when they got there.

David Bermingham, Gary Mulgrew and Giles Darby are accused of having advised their employer, NatWest, to sell part of an Enron company for less that it was worth. American prosecutors say they then left the bank, bought into the firm on their own account and sold it off for a profit of about £1.5m ($2.7m) each.

Although the “crime”, if there was one, took place in Britain, the government insists that, under the terms of a bilateral extradition treaty agreed in 2003 and a subsequent act incorporating its provisions, the men must face justice in Texas. The attorney-general, Sir Peter Goldsmith, says that Britain's Serious Fraud Office had decided not to investigate because “the main evidence was in the USA” and “the alleged fraud could not have occurred without the complicity of Enron executives”.

The NatWest Three are not the first to be extradited from Britain to America under the new procedures; 13 people had been handed over before July 13th. But they have attracted enormous public support. There is a growing sense of injustice over the terms of the treaty, which make it easier for America to get its hands on suspects in Britain than vice versa, and the fact that America has not yet bothered to ratify it (see article). Businessmen fear that they too might face draconian sentences across the Atlantic and are checking that their insurance covers extradition. A lurking resentment of America's power and the belief that the British government is in thrall to it has contributed to the unease.

Urged on by most newspapers, the director-general of the Confederation of British Industry and the mayor of London, Conservatives, Liberal Democrats and even a few of the government's own supporters united in an unusual protest. On July 11th the House of Lords voted to remove America from the list of countries to which Britain allows fast-track extradition until the treaty is ratified. In an emergency debate in the Commons the next day, Nick Clegg, the Lib Dem home-affairs spokesman, criticised the “lopsided treaty which short-changes the interests of British citizens and those under our judicial protection”. The prime minister's response was to send a Home Office minister, Lady Scotland, to Washington in a vain bid to get the Senate to ratify the thing.

Adding to anguish over the affair, on July 12th police found the body of a man hanging from a tree in a London park. He was later identified as Neil Coulbeck, who worked for Royal Bank of Scotland, NatWest's parent, and was believed to have been interviewed by the FBI in connection with the Enron case.

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Banks and borrowing

Sounding the retreat

Jul 13th 2006
From The Economist print edition

The banks pull back on consumer lending

IT COULD not have been clearer that consumer lending was out of control in 2003, when the Royal Bank of Scotland offered Monty Slater a credit card with a £10,000 ($16,300) limit and the chance to earn air-miles. Monty was, according to his owner, a “lovely shih-tzu” dog.

Encouraged by a decade-long housing boom and low interest rates in recent years, the British have borrowed with abandon. In June 2004, for the first time, total consumer borrowing exceeded the £1 trillion mark, roughly the equivalent of the country's economic output that year. Most of the debt is secured against mortgages. But borrowing has been rising fastest on credit cards, overdrafts and small unsecured fixed-term loans.

On July 12th, in its half-yearly Financial Stability Review, the Bank of England listed household indebtedness as one of six vulnerable points in the financial system. It has increased from about 100% of annual disposable income in the 1990s to around 150%, it said. And much of the lending appears to be going to those who can least afford to pay it back.

Citizens Advice, a charity, sees some of the worst over-indebtedness in some of the country's poorest areas. The 1.3m cases it deals with each year are brought by people who typically have household incomes only half the national mean. Yet those who turn to the group for help owe an average of £13,150 ($24,300) apiece. That figure has increased by nearly a third over the past three years and is now more than 17 times monthly household income.

The Consumer Credit Counselling Service, another charity, has found that low-income families are generally more highly leveraged than those with higher incomes. A survey of its clients showed that those earning less than £10,000 a year had average debts of £20,316, or 3.3 times their annual income. Those earning more than £30,000 a year, by contrast, had debts of £69,737, but a debt-to-income ratio less than two to one.

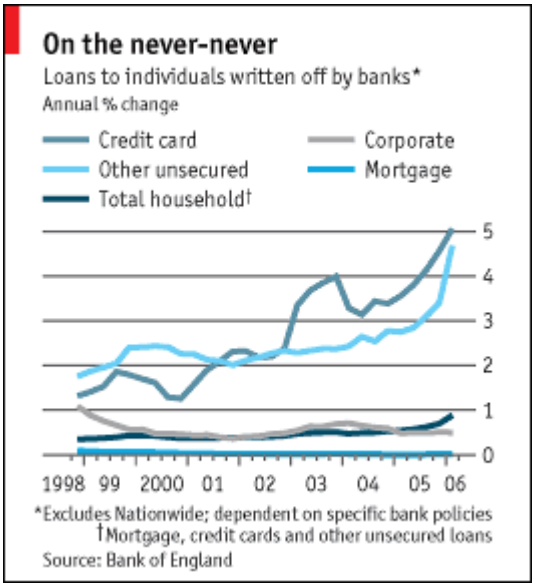
Small wonder then, that personal bankruptcies jumped by 51% to 15,389 in the first quarter of this year from the same period a year earlier, encouraged by new laws that make it easier for people to rid themselves of debt by declaring themselves bust. Write-offs on unsecured loans have also jumped sharply (see chart).

Most of those declaring bankruptcy have few assets; people with significant possessions tend to lose them when they walk away from their debts and so have a powerful incentive not to do so. For that reason arrears on mortgages tend to be low, though they too are rising. Creditors' applications to repossess houses increased by 29% to 33,442 in the first quarter of 2006 from the same period a year earlier.

The rise in bankruptcies is prompting banks to tighten their lending criteria and increase the rates they charge customers with spotty credit records. Consumers, too, want to cut back. A study commissioned by Alliance & Leicester, a small British bank, found in January that more than half of those surveyed planned to reduce their borrowing. Credit-card balances, growing at an annual rate of about 25% for most of 2004, increased by only 6.4% in April, the Bank of England says.

This change in mood comes not a moment too soon. As recently as December the Bank was worrying that banks' write-offs of unsecured loans were equal to a fifth of their profits and likely to rise. It has taken comfort from the slowing growth in these loans—only to fret now that company borrowing is soaring (see article).

If Monty's credit card represented the consumer-lending bubble at its most inflated, then another absurdity may be a sign that sanity is returning. Mark Thomas, an investment analyst who regularly gets new credit cards to take advantage of special promotions, says that he was recently denied a card because a check showed he already held several. The decision to deny him credit "was conservative", Mr Thomas wrote in June. "Many investors may find that comforting."



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Pawnbrokers

Households in hock

Jul 13th 2006
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Why pawnshops' business is booming

A CHARM bracelet festooned with trinkets, worn and slightly dented, hangs in the window of a pawnshop in Paddington, in west London. It was a gift from a man to his wife, says Bernard Mooney, the shop's manager. Every year he would add a new trinket, until the two ran out of money. They pawned the bracelet and were given, as is usual, a loan for less than a third of its value. But they could not pay it back, and the bracelet is up for sale at a snip. “You hear the saddest stories”, says Mr Mooney. “But you also get people saying, ‘You've saved my life.’”

Pawnshops are saving more and more lives these days. It is hard to say how many pawnbrokers there are because they are lumped with other consumer-credit firms in official statistics. But the National Pawnbrokers Association reckons the number is between 800 and 900, and growing. Harvey and Thompson, Mr Mooney's employer, has 69 shops and plans for another 30 in the next three years. Albemarle & Bond, the other national chain, has 75, twice as many as in 1998. In May Harvey and Thompson floated on the Alternative Investment Market (AIM). It hopes to mimic the success of Albemarle & Bond, whose share price nearly doubled last year. Both firms report mounting profits.

Why this pawn revival? The biggest reason is that more people—just over 9m—are being denied access to mainstream credit, often for missing loan payments in the past. Until last year the number of sub-prime borrowers had been falling.

Without overdrafts or credit cards, such people struggle to get by. In a survey of pawnshop customers, Elaine Kempson, from Bristol University's Personal Finance Research Centre, found that over half had pawned possessions to buy daily necessities, including food. And although pawnshops' interest rates seem outrageous to more fortunate borrowers, they are cheaper than the alternatives available to the poor. They charge around 7%, or an annual percentage rate (APR) of 100%, for a typical six-month loan. Unsecured home—or doorstep—credit has an average APR of about 175%. Borrowers may of course value the convenience of making payments at home and the fact that occasional late payments are not penalised.

Another reason for pawn's resurgence is the switch from weekly to monthly pay days, increasing demand for small sums that can be swiftly raised and repaid. Then there is the exodus of banks and post offices from the high street. Immigration may also play its part: Mr Mooney says many south Asians, who tend to keep some capital in gold, pawn 22-carat pieces.

To exploit this demand, pawnbrokers are shedding their dingy, Dickensian image. Harvey and Thompson's shops are airy and light; their windows look like those of high-street jewellers, with unredeemed goods buffed up and arranged on velvet. The firm has opened branches in shopping malls and attracted new customers by offering cheque-cashing, pay-day advances and pre-paid credit cards.

The ancient business of pawnbroking remains essentially unchanged. But for modern borrowers it has new advantages. Pawnbrokers do not make credit checks, and using them does not imperil credit ratings. Because a loan is secured by the piece in hock, risk is finite. Yet although pawnshops are doing well, they are unlikely to replace doorstep lending. After all, to borrow from a pawnbroker, you must first own an object of value.

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About sponsorship

Northern Ireland

Orange peel

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From The Economist print edition

The Orange Order tries to clean up its act

IT IS a mark of how Northern Ireland is changing, as well as how odd it remains by comparison with the rest of Britain, that this year's Orange marches were patrolled solely by the police, without help from the army. Many Catholics nonetheless left cities such as Belfast on July 12th. To them, the noisy celebration of a 300-year-old victory over the Catholic King James II is an act of aggression—a marking-out of traditionally Protestant turf that becomes more provocative every year as Protestants become fewer.

That may be altering, however. This year's celebrations were the most low-key for many years. And Drew Nelson, the Orange Order's ambitious grand secretary, has said that he wants Orange parades to become tourist attractions. A cleaned-up “Orangefest” might, he believes, become a bowler-hatted version of London's Notting Hill Carnival. Northern Ireland's Department for Social Development agrees. It has chipped in with £104,000 ($192,000) to pay for a development officer.

In many parts of Northern Ireland, the prospect of Orangemen posing for the tourists' cameras does not seem so outlandish. Rural Orange lodges can be staid and respectable; some, indeed, resemble fiercely patriotic rotary clubs. They may even talk, albeit surreptitiously, to local Catholics. Partly as a result, their parades are mostly peaceful. Last year, Protestant loyalists held 2,336 parades, only 26 of which were disorderly, according to the police.

In Belfast, though, it is a different story. Middle-class Protestants have drifted away from the city—Mr Nelson lives not in Belfast but in nearby County Down. To keep up the numbers, urban lodges have admitted less respectable folk. Unable to muster bands of their own, many rely on freelance “blood-and-thunder” or, as they are sometimes known, “kick-the-pope” flute bands for musical accompaniment. Some such bands fly paramilitary flags and celebrate loyalist killers.

Reforming these outfits will prove slow and difficult. But official cash may help, if not for the reason that the Department for Social Development intends. In Northern Ireland, as elsewhere, government cash has a way of making things seem less cool. Those urban thugs who were attracted to the outlaw image of the Orange parades may decide to hang up their drums.

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Psychiatric wards

Sex, drugs and mental health

Jul 13th 2006
From The Economist print edition

What happens when mad people are put in hospitals

Get article background

WHEN mental-health stories make the news, they usually feature a man, often black and distracted-looking, who has absconded from treatment and stabbed a passer-by. Everyone frets that care in the community—treating as many people as possible at home—is endangering the public, and says that more mad people should be put away. That hospitals themselves could be a problem is rarely considered.

That changed this week when the *Times* received a leaked copy of a report that the Department of Health has been sitting on. It said that over a hundred patients had been sexually assaulted while in psychiatric hospitals in the two years to October 2005. At least ten were raped.

Are hospitals for the mentally ill as bad as this suggests? They emerged from a system that placed little value on being nice to patients. Before 1945 those with mental illnesses would normally be consigned to a long-stay hospital and then forgotten. These places, many of which were built by the Victorians on the edges of cities, became convenient dumping grounds for the awkward and untreatable.

In the 1950s most of the old loony bins were knocked down or, like the Friern hospital in Finchley, were turned into flats (the thick walls “subdue sound and inspire feelings of cosiness and security” according to an estate agent). The number of in-patient psychiatric beds in the NHS peaked at around 150,000 in the mid-1950s and has now declined to around 30,000, says the King's Fund, a health think-tank. Most of these beds are in smaller wards near ordinary hospitals or in shiny new freestanding units, though some old asylums, like Springfield hospital in Tooting, survived.

The places that remain are on the whole much better, but some are still bad. Those who work in them grumble that care in the community has made work with patients outside hospital more prestigious and better paid, encouraging lots of good nurses to leave. Pressure on beds means people with different illnesses are lumped together on the same wards, which can make them difficult places to manage. “People who are severely depressed don't mix well with schizophrenics,” says Graham Thornicroft, an academic and a consultant psychiatrist at a hospital in south London. The most recent survey by Mind, a charity that monitors psychiatric hospitals, found that 51% of patients said they had been threatened and 20% assaulted during their stay.

Some reckon that mixed-sex wards are to blame. The Victorians kept the sexes apart for fear that they would procreate; attitudes since the 1960s have tended towards “normalisation,” which often means having men and women on the same ward. Current fashion has moved back to separation: the government had a target to make all wards single-sex by 2002. But mixed wards are still common: a survey by the Healthcare Commission, a quango, recently found that 78% of patients were on mixed wards during the day (mixed-sex sleeping wards are rare).

The easy availability of illegal drugs in psychiatric hospitals is probably a bigger problem, though. “Many in-patient wards are awash with illicit drugs,” says Tony Zigmond, vice-president of the Royal College of Psychiatrists. “Dealers come on to wards, and patients become dealers.” The drugs prescribed to schizophrenics are powerful and have horrible side effects; mixing them with drugs like cocaine makes them even worse. And where mental illness correlates with violence, illegal drugs seem to be the catalyst. Getting them off the wards would be a good first step.

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London water

Sunk costs

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Thames Water draws interest from a surprising quarter

THE last time Londoners paid this much attention to the maze of pipes beneath their feet was during the Great Stink of 1858, when Joseph Bazalgette was commissioned to build the city's famed Victorian sewerage system. Now, in the middle of what looks likely to be London's fourth-driest year since records began, barely a day goes by without its inhabitants pondering the reticulation under its streets.

On July 12th the Environment Agency started a public hearing into whether Thames Water, the city's main water utility and the country's leakiest, should be awarded a drought order that would allow it to ban car-washing, the splashing of ornamental fountains and the filling of swimming pools. The order would supplement one that already prohibits many in the south-east from using hosepipes.

Little more than a week earlier, Britain's water regulator had said that the firm's failure to meet targets on plugging leaks from its rusty Victorian pipes was unacceptable and warned that it would face fines from 2007 unless it started hitting its goals. And less than a month ago London's mayor, Ken Livingstone, described the company's record as the “unacceptable, unsustainable and irresponsible face of privatisation” in a submission to a public inquiry into his decision to turn down its application to build a desalination plant.

Given Thames Water's troubles, one might not expect to find a string of bidders queuing up to buy it, but that is exactly what is happening. This week Terra Firma, a buy-out firm, and Australia's Macquarie Bank emerged as potential buyers in a deal that may value Thames Water at more than £7 billion. RWE, the German utility group that owns it now, has been planning since November to sell or float its British and American water companies.

That a firm such as Terra Firma has emerged as a leading contender for Thames Water says something about the risks that face the company. Buy-out firms normally demand higher returns than infrastructure funds, another sort of private-equity business, but are willing to take chancier bets. It is also an indication that private-equity companies increasingly see utilities as cash-generating companies that can easily be loaded up with debt.

As such, Thames Water's attractions are obvious. Despite its dismal record in fixing leaky pipes, it is effective at generating cash. In the 12 months to March 2006 it had a pre-tax operating margin of 34% on its regulated British revenues of £1.4 billion.

And its regulator is a soft touch. Prices for the five years to 2010 may rise as much as 22% in real terms to finance improvements in the firm's infrastructure. Though OFWAT tries to talk tough, chastising Thames Water for missing its water-leakage targets since 2000, last week the regulator in fact eased those targets for the next two years.

With London's population growing, Thames Water's biggest problem will be finding water to meet increasing demand. That means decades of capital investment and, unless its regulator toughens up, more price increases for Londoners.

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Bagehot

A foolish promise

Jul 13th 2006
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David Cameron faced the first crisis of his leadership. And guess what? It was about Europe

IT MUST have seemed a good idea at the time. But David Cameron's commitment to pull Conservative members of the European Parliament (MEPs) out of the centre-right European People's Party (EPP) group had become the political equivalent of a rotting albatross hanging around the Tory leader's neck. On July 13th he was forced to admit as much when he announced that nothing would now happen until 2009, after the next European Parliament elections. It was a necessary climb-down but nonetheless embarrassing.

It is worth recalling the circumstances of Mr Cameron's ill-fated pledge, the only one he made during his bid for the leadership. At the time, last summer, his campaign appeared becalmed. But the votes of some of the party's hard-core Europhobes were still up for grabs. They were not going to go to the Europhile Ken Clarke, and the odds-on favourite, David Davis, supported by several leading pro-Europeans, felt strong enough to rule out making concessions he might later regret.

The last thing that Mr Cameron wanted was to look like a Euro-obsessive: he knew the damage which that impression of his party had done in successive elections, and anyway it is just not his style. But the deal he was offered seemed harmless enough; the kind of thing that only the most dedicated political anoraks would give a hoot about. Nobody in Britain, reasoned Mr Cameron, has the faintest idea what goes in the European Parliament and there was something a bit rum about Tory MEPs hanging out with a gang of German and French federasts.

Chief among the siren voices was Daniel Hannan, not only an MEP but also a *Daily Telegraph* leader-writer and an indefatigable critic of the European Union and all its works. Mr Hannan convinced Mr Cameron that in the new Europe of 25 member countries there were staunchly Atlanticist and free-market eastern Europeans queuing up to be part of a dynamic new anti-integrationist, centre-right group led by British Conservatives.

With a knowledge of European politics that even his admirers admit is patchy, Mr Cameron decided to believe Mr Hannan. He also made the mistake of failing to discuss the matter with Mr Hannan's fellow Tories in the European Parliament. This was unwise since a large majority of Mr Hannan's colleagues disagree strongly with him about almost everything.

Had Mr Cameron consulted them, they would have pointed out that it might be difficult to explain back home what it was about British Tories that made it impossible for them to rub along with just about every other mainstream conservative party in Europe. And that if he didn't have an explanation, Labour would be only too happy to supply one. They would also have reminded him that his three predecessors had looked at the arguments for leaving the EPP and rejected them, recognising the influence that came from being a powerful component within the parliament's biggest, best-organised group.

Ironically, the job of negotiating the Tories' departure from the EPP and finding them a suitable new abode fell to William Hague, whom Mr Cameron lured back into front-line politics to be his shadow foreign secretary. Seven years ago, it was Mr Hague, with the help of the German Christian Democrats, who reached a settlement with the EPP that allowed the Tories to take a Eurosceptical line on institutional issues such as the European constitution, while still giving them a generous share of committee chairmanships and other spoils. It is fair to say that Mr Hague's heart has not been in this mission.

His doubts were reinforced by the failure to find appropriate allies. The only more-or-less respectable parties who showed even the slightest interest in linking up with the Tories were the Czech Civic Democratic Party (ODS) and the Polish Law and Justice Party (PiS). It's hard to see what—other than Euroscepticism—PiS, a party whose leader recently tried to stop a gay rights march in Warsaw and wants both to ban abortion and to bring back the death penalty, has in common with Mr Cameron's compassionate conservatism. The PiS is also a great admirer of the common agricultural policy and holds un-Tory views about state intervention in the economy. As for the ODS, it decided this week to stick with the EPP, but allowed Mr Cameron to save a little face by saying it would join up with the Tories in 2009.

Bad company

Confronted with the impossibility of forming a new group, Mr Cameron could hardly have ordered his MEPs to sit with the "*non inscrits*" or non-attached parties. These include neo-fascists such as Jean-Marie Le Pen's Front National, Austria's Freedom Party and Umberto Bossi's Northern League. Oh, and Robert Kilroy-Silk, late of the UK Independence Party. No wonder at least two-thirds of the Tory MEPs were in open revolt; no wonder European conservatives such as the German chancellor, Angela Merkel, and the leading presidential candidate of the centre-right in France, Nicolas Sarkozy—natural allies of any Tory prime minister serious about reforming Europe—have been both bewildered and infuriated with Mr Cameron's antics. Even American Republicans, such as George Bush senior and John McCain, had expressed their dismay.

Belatedly, Mr Cameron realised that he had dealt himself some lousy cards. When he realised just how lousy, he sensibly followed the first rule of bridge, which is to get rid of them quickly. Whether anything will come of his latest promise to form a new grouping in 2009 is open to doubt. Three years is a very long time in politics. As for Mr Hannan, if he and a few kindred spirits want to go elsewhere, they should be free to do so.

Mr Cameron will have to endure Labour gibes that he is a flip-flopper and a lot of Tory activists, who have been pumped up by Mr Hannan, will, for a time, feel badly let down. But all the other options open to him were much, much worse.

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South African business

Going global

Jul 13th 2006 | JOHANNESBURG AND LUSAKA
From The Economist print edition

Shoprite

South Africa's big companies have spread their wings abroad

AT THE Manda Hill and Arcades shopping centres in Lusaka, it is easy to forget that you are in Zambia's capital. For those travelling north from South Africa, the scene is eerily familiar: they can shop at the Shoprite or Woolworths supermarkets and go for a bite to eat at Debonair Pizza. MTN pre-paid mobile-phone cards are for sale at traffic lights and there is a choice of films at the Ster-Kinekor cinema or on the M-Net satellite-television channel. Only 15 years ago, when South Africa was still under apartheid, this was unthinkable. But after the lifting of international sanctions and the relaxation of capital controls, South African companies quickly caught up with the rest of the world. This changed the business environment not just within the country itself, but throughout the region, and partly explains why South Africa was invited to this week's G8 summit along with emerging heavyweights China, India, Brazil and Mexico.

South Africa now boasts many successful multinationals. Their achievements vividly illustrate how firms from developing countries can prosper abroad, especially in emerging markets, which they understand and can sometimes navigate better than their rich-world competitors. The Anglo American Corporation and De Beers are among the top mining companies in the world. SABMiller has become a global brewing giant. Sappi is big in the world of paper, and MTN has become a household name in many African countries. Dimension Data (Didata), which provides computer services, operates in over 30 countries. Old Mutual—South Africa's biggest financial firm—bought Sweden's oldest insurance company last year. And Sasol, an energy and chemicals company, operates in over 20 countries worldwide. What explains South African firms' rapid global expansion?

The release of Nelson Mandela in 1990 heralded a big change for South African business, which had been confined within its own borders for much of the previous decade. The rest of Africa was no longer out of bounds. The lifting of American sanctions against South Africa in July 1991, and of UN restrictions a few years later, opened the doors to the world.

But South African firms had to remake themselves first. Their inability to invest abroad prompted local companies to invest in each other. As a result, the business landscape was dominated by conglomerates enmeshed in complicated crossholdings. Besides mining, for example, Anglo American was involved in beer, banking, insurance and media. Similarly, South African Breweries (SAB)—which counted Anglo

American among its shareholders—had interests in hotels and retail chains, and also manufactured shoes, furniture, textiles and matches.

For computer firms like Didata, set up in 1983, sanctions meant that the technology they needed, much of which originated in America, was largely out of reach. This obliged the company to develop its own systems and become self-sufficient. “We had to do it all ourselves,” recalls Jeremy Ord, Didata's chairman. Isolation also shielded South Africa from competition, which in some industries helped to foster the creation of national champions.

Once they were able to turn their gaze beyond their own borders, South Africa's business octopuses started selling their non-core assets. From inward-looking, tentacled conglomerates, many transformed themselves into global firms focused on particular markets. Although big companies still dominate South Africa's business landscape, their grip has loosened considerably and international exposure has transformed their corporate cultures.

Out of Africa

To compensate for their late arrival on the international scene, South African businesses went on a shopping spree. SAB was quick to move. The collapse of the Soviet Union meant that many state-owned breweries in eastern Europe and in Africa were up for grabs. In 1993 the company bought a stake in Tanzania's loss-making national brewer and invested in Hungary. By 2000 it had moved into another five African countries, as well as Poland, Romania, Slovakia, Russia and the Czech Republic. “European brewers did not seem to be moving quickly enough,” says Malcolm Wyman, the group's chief financial officer. This meant SAB was the first to establish strong positions in regions that other big brewers neglected. It moved into China in 1994 and acquired Miller, an American brewer, in 2002. SABMiller—as the company is now known—became the second-largest brewer in South America when it bought Bavaria, a big drinks firm based in Colombia, last year.

Access to cheaper capital—and a lot of it—has been essential. The gradual lifting of capital controls and the ability to list on the London Stock Exchange both boosted the foreign expansion of South African firms. In the late 1990s the new democratic government allowed several companies—including Anglo American, SABMiller, Old Mutual and Didata—to move their primary listings to London. Mr Wyman says SABMiller's big acquisitions over the past few years would not have been possible without the LSE listing. Mr Ord points out that listing in London, with the corporate-governance and transparency requirements this entails, helps to establish credibility with foreign clients.

Many South African companies start by spreading their wings close to home. Banks, retail chains and mobile-phone companies have been particularly active investors in the rest of Africa. Standard Bank and ABSA, two of the largest South African banks, are very bullish about the region. Didata has been active in over 20 countries in Africa—or “emerging Africa”, as it calls it—often providing infrastructure for MTN's mobile networks.

South Africa is now one of the top investors in sub-Saharan Africa, and has helped to spur economic development. New mines mean more exports and foreign exchange. Millions of Africans have access to phones, often for the first time, thanks to Vodacom and MTN. In Uganda and Zambia SABMiller is working with local farmers to produce sorghum for use in brewing. The firm also grooms local entrepreneurs to distribute its beer and soft drinks. South African investors provide formal employment where jobs are scarce and beef up tax revenues in economies dominated by the informal sector.

The picture is not all rosy. South Africa is sometimes seen as a neo-imperialist hegemon. Supermarkets, for example, are accused of pushing South African products and putting traders and small farmers out of business. But roughly 85% of foreign investment by South African-based firms is in Europe and North America.

The transformation of South Africa's local champions is part of a broader emergence of new multinationals. Think of Hutchison Whampoa of Hong Kong, Tata of India, Mexico's Cemex, or Malaysia's Petronas. Investment by such firms is becoming a big source of capital for poor countries: half of foreign telecoms investments in Africa came from other developing countries, according to the OECD. Although such multinationals sometimes find it harder to invest outside their home regions, their strength lies in their ability to straddle the rich and poor worlds.

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Mobile telecoms

The right to roam

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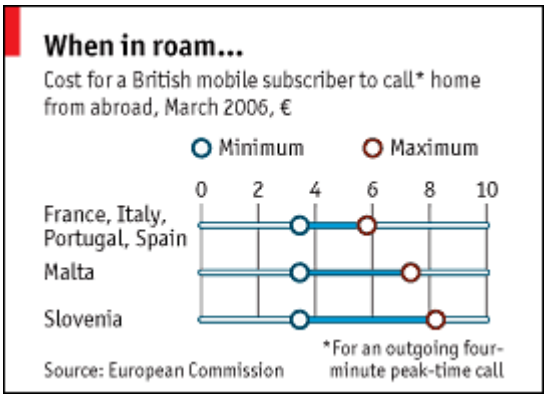
The European Commission moves to regulate the cost of mobile calls abroad



IS IT a humiliating climb-down or a draconian intervention in the free market? On July 12th, after months of ever-changing proposals, the European Commission released a plan to cap the prices that people pay to use their mobile phones abroad. The rules are a vast improvement on earlier, unworkable ideas (such as free inbound calls or forcing operators to match the lowest price from anywhere in the European Union). Yet they still represent a blunt regulatory bludgeon for a commission that claims to prefer a light touch.

Today, the average price for a "roaming" call is around €1.15 (roughly $1.50) per minute, the commission estimates, which is as much as five times the cost of providing the service. Under the proposals put forward by Viviane Reding, the commissioner responsible for telecoms and media, the price of calling anywhere in the EU from abroad would be capped at 49 euro cents per minute; the price of local calls would be at most 33 cents per minute; and receiving a call while abroad would cost no more than 16.5 cents per minute.

Lowering the cost of roaming will not only save consumers money, but "enhance the competitiveness of Europe's industry," says Ms Reding. The plan caps wholesale prices (what one operator charges another) at between two and three times the average cost of delivering a mobile call domestically in Europe. Operators may charge their customers only an additional 30% on top of that sum to make calls. The price of receiving a call while abroad will also be capped, using a similar formula. The retail-price cap on outgoing calls will kick in six months after the cap on wholesale prices, to give operators time to adjust. Without retail price controls, says the commission, the wholesale caps will have no effect.

Roaming fees account for roughly €8.5 billion, or 5.7% of the operators' revenues. The reason for the huge price mark-up is ostensibly because when a customer uses his phone abroad, a network operator in the foreign country must both provide a connection and link its billing systems with that of the subscriber's home operator. But the inflated prices are also due to a lack of transparency and a failure of competition to reduce prices, says the commission. Customers rarely consider roaming fees when choosing operators, and it is in all operators' interests to keep prices high.

Mobile phone operators, predictably, are apoplectic. The plan has "serious flaws", is "unnecessary", would do "significant damage", is "not in the interests of consumers" and will "stifle competition", says the GSM Association, a trade group that represents the operators. Presumably the firms will earn less money, too. They argue that voluntary price cuts show the market is working. Yet it has only been since the EU threatened regulation earlier this year that Vodafone, Orange, T-Mobile and other operators have announced plans to cut their roaming charges by around 50% in the next few months.

However, although the cost of roaming seems excessive, the EU's rules might indeed undermine innovation in pricing. For instance, the EU's retail-price caps apply to the price per minute—which could prevent operators from offering cheaper roaming charges based on bundles of minutes or a one-time connection fee. The regulations wrongly presume "one size fits all" when it comes to pricing, says Richard Feasey of Vodafone, Europe's biggest operator. He argues that the operators' marketing departments have a better record of thinking up packages for customers than officials sitting in Brussels do.

The commission's plan still needs approval from the European Parliament and Council of Ministers, and would then come into effect in the summer of 2007. Yet although price controls are a hugely intrusive

intervention in the market, the operators may yet have the last laugh. The majority of mobile subscribers do not use their phones when travelling abroad, because it costs so much. As the price of roaming falls, operators may well find that more use makes up for lower margins.

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Telecoms

Who's your Daddy?

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The tussle over PCCW shows China's disregard for minority shareholders

SO CHINA got its way after all. The takeover battle for PCCW, Hong Kong's incumbent telecoms company, ended this week before it had even properly begun. On July 10th Francis Leung, a local tycoon, stepped in to buy a 23% stake in PCCW held by its founder and chairman Richard Li, for HK$9.2 billion ($1.2 billion). Mr Leung's offer, for the moment at least, scuppers bids from two private-equity firms, Australia's Macquarie Bank and America's TPG-Newbridge, which were both willing to pay HK$60 billion for all of PCCW's telecoms and media assets.

That Mr Leung appeared on the scene so quickly is surprising; the original bids became public just a few weeks ago. That he has appeared at all is less so. The Chinese government, through China Netcom, a state-owned telecoms group that owns 20% of PCCW, opposed a “foreign” takeover and wanted the Hong Kong firm to stay in local hands. Netcom believed that Mr Li's attempt to sell the firm's assets violated a pact that gave Netcom a say in any sale of the company. That Mr Li apparently did not mention this pact to the private-equity bidders suggests that he knew his planned sale would displease his Chinese partner.

Though Macquarie and Newbridge were prepared to bring Netcom and Hong Kong investors into their consortia and dilute themselves into a minority position, it was not enough. As the co-founder of Peregrine Investments, a Hong Kong investment bank that pioneered the flotations of “red chip” mainland companies on the Hong Kong stockmarket in the 1990s, Mr Leung's strong links with China proved decisive. Though Peregrine went bust during the Asian financial crisis of 1997-98, Mr Leung emerged unscathed and went on to hold senior jobs, including one at Citigroup Asia. Most importantly, he is the favourite banker of Li Ka-shing, Hong Kong's richest man and the father of Richard Li, whose takeover of Hong Kong Telecom by PCCW Mr Leung helped to organise in 2000.

This week's deal means that Hong Kong's main telecoms assets stay in local hands, but are in effect controlled by Netcom. Macquarie and Newbridge go away empty-handed, at least for now. One person close to events, however, believes they could end up taking a stake in any consortium formed by Mr Leung to finance the purchase of his stake.

It is PCCW's public minority shareholders who are the clear losers. Mr Li hopes to appease them by paying them around HK$0.35 a share as a special dividend from his own pocket. That is the difference between PCCW's share price before takeover talks started and Mr Leung's offer: Mr Li is, in effect, giving away his premium. Even so, minority shareholders stood to gain far more from a sale to one of the two private-equity bidders; and PCCW's share price has fallen more than 90% since 2000.

Mr Li comes out smiling, having struck what was probably the best deal he could get. He collects cash for most of his stake (though he is allowing Mr Leung to pay 70% of the total price later) and can now focus on other ventures. The chief damage is to his ego. Mr Li's attempt to escape from his father's shadow by building up PCCW over the past few years has failed. All the talk in Hong Kong is that his exit, via Mr Leung, was at least partly arranged by Dad. At the same time, this sorry saga demonstrates with equal clarity that Hong Kong's real daddy is Beijing.

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Japan's steel industry

A changed game

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AP

Consolidation elsewhere puts pressure on Japan's suddenly small steelmakers

THE five-month battle that culminated in the news late last month that the world's two biggest steel companies, Mittal Steel and Arcelor, both headquartered in Europe, were to merge, has put the wind up Japanese steelmakers half a world away. Until recently, they could persuade themselves that they were on a roll. Starting in the late 1990s, a wave of consolidation refashioned Japan's fragmented steel industry. The process was driven by high debts, poor profitability and by carmakers' threats to cut their number of steel suppliers. Long-standing rivalries were put aside as steelmakers were crunched into five main groups. The timing was perfect: the merged groups, with their expertise in making high-grade steel products, have since prospered from booming car- and ship-building industries at home and, abroad, from a seemingly insatiable appetite for steel in China. In particular, Nippon Steel, Japan's biggest steel group and hitherto the world's third-largest, appeared to be thriving.

But the proposed $32 billion sale of Arcelor to Mittal upsets all the old assumptions. Arcelor Mittal will be the world's biggest steelmaker by stockmarket value, revenue and output. At roughly 110m tonnes a year, its output will be comparable to the combined total of Japan's four biggest steel groups—Nippon Steel, JFE Holdings, Sumitomo Metal and Kobe Steel. Overnight, Nippon Steel, even if it now becomes the world's second-biggest steelmaker, will have gone from being a close competitor of Mittal and Arcelor to being barely a third as big, measured by output. To make matters worse, Nippon Steel previously struck technology-sharing deals with Arcelor, among others, in order to be able to follow Toyota and other carmakers into Europe. The future of such ventures is now in doubt.

Accordingly, Japan's steelmakers are now wondering how vulnerable they are to foreign takeover—after all, changes to Japan's corporate law next spring will, in theory, enable foreign-listed firms to use their own shares for the first time when bidding for Japanese companies. Nippon Steel is taking no chances. In recent weeks it has introduced poison pills designed to ward off foreign bidders. On July 4th it said it was buying back up to 4%, or ¥100 billion ($873m), of its own shares, the second such buyback this year. It has raised to 15% its stake in a maker of ball bearings, Sanyo Special Steel, and is expected to buy shares in other specialist steelmakers to create a web of interests. And, at a time when the trend among Japanese companies has been to reduce the stakes many have long held in each other, Nippon Steel has been increasing its cross-shareholdings with Sumitomo Metal and Kobe Steel.

To some observers, such actions appear not only to be old-fashioned, but also unnecessary. Cultural and regulatory barriers in Japan to a foreign hostile bid may well prove insurmountable, even for a cash-rich bidder. Besides, high share valuations, most analysts agree, would put Nippon Steel and most other

Japanese groups well out of reach. Nippon Steel presumably knows this. So one theory is that it is trying to impress upon Japan's Fair Trade Commission the need for yet more consolidation among Japanese steelmakers. Currently, the commission appears to think that concentration in the domestic market for steel has gone far enough. Some Japanese steelmen, on the other hand, think that the pan-Asian market for steel, not the domestic one, should form the basis for that judgment—the market, in short, from which Japanese steelmakers have hitherto prospered but which the new Arcelor Mittal group might now be poised to attack.

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Piaggio

Generating a buzz

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The firm behind Italy's Vespa scooter floats on the Milan stockmarket

“FOR Americans, the Vespa is a toy,” says Roberto Colaninno, chairman of Piaggio, Europe's biggest scooter-maker. Since the brand was relaunched in America in 2000, the mother of all motor scooters has been a big hit, thanks to its retro styling and Italian flair. Even the New York Police Department uses the chic two-wheelers to zip around the city.

Yet Mr Colaninno has bigger ambitions for the company he took over from Morgan Grenfell Private Equity. In spite of tepid investor enthusiasm, he went ahead with the listing of Piaggio's shares on the Milan stock exchange on July 11th, albeit at the bottom of the price range offered to investors. (Api, an oil company, and Pirelli, a tyremaker, recently cancelled their planned listings.) Mr Colaninno plans to boost Piaggio's presence in emerging markets, especially India and China. Ultimately, he wants to take on Honda, Suzuki and Yamaha, the Japanese firms that dominate the scooter market.

When Mr Colaninno's Immsi holding company bought a controlling stake in Piaggio in October 2003, the firm was in a mess. The loss-making group's debts were €577m ($606m), or 60% of its annual sales. Workers were frustrated and confrontational. The product range had lost its shine and three-quarters of scooters went wrong within the first six months.

Mr Colaninno cut costs through a joint venture in China that allows Piaggio to source cheaper components. He improved relations with his workforce by striking a new deal with the unions, which included the introduction of air conditioning in the sweltering factories. And he acquired Aprilia, another Italian scooter-maker, to give the group more scale.

So far the Colaninno cure seems to be working. Last year Piaggio reported a €37.9m profit on sales of €1.5 billion. But to compete successfully with the Japanese, Mr Colaninno wants to go beyond traditional two-wheelers. Inspired by the popularity of hybrid petrol-electric cars, Piaggio is developing hybrid scooters: municipal authorities in Milan, Florence, Naples and Rome are now testing the new “green” Vespa. A few weeks ago the firm also launched the MP3, a three-wheeler with two front wheels, in Piazza del Campidoglio, one of Rome's central squares.

Though the company remains highly indebted and both Aprilia and Moto Guzzi (another scooter-maker owned by the group) still need to turn the corner, Piaggio can celebrate the Vespa's 60th birthday this year with some confidence. Established in 1884 by Rinaldo Piaggio, the company has made ships, aeroplanes and helicopters over the years. It transformed itself into a pure scooter-maker after the second world war, when Corradino D'Ascanio, a talented engineer who was also a pioneer of the helicopter, came up with the idea of a user-friendly two-wheeler called the Vespa—the Italian for “wasp”. Three years later Piaggio began to produce the Ape (Italian for “bee”), a three-wheeled vehicle that has become especially popular in India. Piaggio's production there has almost quadrupled in the past couple of years.

When Mr Colaninno bought Piaggio, many assumed that he would try to turn the company around and quickly then sell out. Yet Immsi did not sell any shares in this week's IPO. Mr Colaninno, who has been boss of Telecom Italia and Olivetti, says he is happy to return to his origins. He started his career in the car industry and founded Sogefi, a car-parts firm, in the 1980s, which he took public and made into a success. He clearly hankers after one more ride.

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Executive onboarding

That tricky first 100 days

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The business of helping executives get off to a good start is booming

BEING boss of an American firm may be fabulously well paid, but never has the position of top banana been harder to cling on to. According to Challenger, Gray & Christmas, a consultancy, 728 chief executives left their jobs in the first half of this year—some willingly, many not. That was 6.9% more than during the same period in 2005, a year with an all-time record high of 1,322 departures. Many of these changes were at smaller firms, but there have recently been several sudden, high-profile exits at firms including Kraft, Novell and Williams-Sonoma.

With increased turnover comes reduced tenure in the top job—and, indeed, in other senior positions. Executives are now being judged more quickly than ever, it seems. This trend has spawned a business designed to help newly appointed corporate leaders to hit the ground running. “The average CEO is in the job for under four years now,” says Rich Rosen of Heidrick & Struggles, a recruitment firm. “So firms are looking for a new CEO to make a quicker impact, and are prepared to invest in making sure it happens.” Reflecting the management industry's addiction to jargon, this process has been named “onboarding” (that is, helping a new executive successfully climb on board).

Among those offering onboarding are the big recruitment firms, including Heidrick, which in the past two years has added several “accelerated transition” experts to its leadership practice, and various management consultancies, including McKinsey. Heidrick sometimes works with Michael Watkins, a management professor at INSEAD, an international business school, who is the author of the onboarding bible, “The First 90 Days”. (Political leaders may be afforded the luxury of 100 days, but not corporate bosses, he reckons.) There are even onboarding specialists, such as PrimeGenesis—named to evoke good beginnings, despite sounding like a Bond villain's front company.

Heidrick tried to buy PrimeGenesis before deciding to build its own onboarding practice, which it regards as a sensible extension of its recruitment business: pick the right person and then help that person to succeed. This combined approach might help to ease growing concerns in America's boardrooms about the quality of the bosses provided by recruitment firms. Academic studies have found that, on average, outside hires tend to perform far worse as chief executives than internal candidates do. Similarly, McKinsey may be hoping that helping a new boss to make a good start will make him more inclined to award consultancy work to the firm later in his tenure.

Onboarding focuses on three areas that can cause a new executive to fail: getting up to speed, forging effective relationships and accomplishing what is expected. “The era when a chief executive could come in, take a couple of years to get to know the business then formulate a long-term strategic plan, is over,” says George Bradt, the founder of PrimeGenesis. Instead, a new boss should ideally have picked his new team and have a communications strategy—if not a fully worked-out business plan—in place on his first day in the job. To this end, PrimeGenesis particularly emphasises making the most of “pre-boarding”—the period between an executive accepting the job and officially starting it.

Unlike executive coaching, which focuses on the career-development of an individual executive, onboarding firms concentrate more on establishing teams. New bosses often fail to work out which relationships matter. They should have two priorities, says Mr Bradt. First, identify the “shadow board”—that is, who is really pulling the strings upstairs: a member of the real board, perhaps, a former senior executive, or a big shareholder. “It's usually the shadow board that does in a new chief executive,” says Mr Bradt.

Second, new executives should single out the executives who could undermine them, such as those with strong relations with members of the “shadow board”, or those who were passed over for the top job.

Particularly in “hot landings” (when a new executive needs to bring about big changes fast), if others who wanted the top job do not make it clear that they are both loyal and enthusiastic within the first two months, they should be removed, says Mr Bradt. New bosses “tend to move too slowly on people like that, but you don't have time for insubordinate subordinates,” he says.

As for accomplishments, the secret is, first, to ensure that what is expected of the new executive is clear and agreed on; and, second, for the executive to notch up some quick, unarguable victories. A couple of triumphs early on can do wonders for the credibility of the new boss and the motivation of his team.

At LexisNexis, a business-information firm that is a client of PrimeGenesis, Mike Walsh went through what he calls a “fascinating and essential” onboarding process. Before starting as head of its big legal division, he and PrimeGenesis sorted through his web of relationships to work out “who my main stakeholders were and what I needed to achieve with them, which, frankly, I wouldn't have thought about,” he says. A plan was drawn up covering everything from schedules for initial and follow-up meetings, team formation and setting achievable milestones. This was so successful that Mr Walsh was recently promoted, and has hired PrimeGenesis to work with his new team.

Onboarding may not always work so well, of course. Nor is it cheap: PrimeGenesis charges $50,000 for each executive, for instance, and the firm is not on-site much of the time. (An executive coach, by comparison, might charge anything from $200 per hour to $15,000 a day.) Still, it is cheap when compared with the costs that arise when a new boss goes overboard—perhaps after being made to walk the plank.

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Face value

Surfing the airwaves

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Craig McCaw was a pioneer of mobile telephony. Now he is betting on a new wireless-broadband technology

“THE greatest ideas you will ever have are the ones that other people don't understand,” Craig McCaw once told an interviewer at the Academy of Achievement, an organisation that exposes young people to great visionaries in various fields. Mr McCaw had been inducted because he is just such a visionary, in the field of wireless communications. Starting in 1981 he began borrowing lots of money to buy licences for radio frequencies that America's telecoms regulator was making available. Some people called it a “land grab” of spectrum; various self-styled “experts” derided it. But Mr McCaw kept going and made his firm, McCaw Cellular, the largest mobile-phone operator in America. In 1994 he sold it to AT&T for $11.5 billion, although he refused to join AT&T's board because, as an eccentric and a recluse, he hates long meetings and social pleasantries. His firm is now part of Cingular, America's biggest mobile operator.

The solitary Mr McCaw, who will turn 57 in August, is still doing his thing. For the past few years, he has again been piling up vertiginous mountains of debt to buy wireless spectrum in America and parts of Europe. His main corporate vehicle today is a firm called Clearwire, based in his home state of Washington, and loss-making so far. Unlike McCaw Cellular, Clearwire is not—at least not primarily—about wireless voice communications, but about high-speed (or “broadband”) wireless internet connections which can also, naturally, carry voice.

Last week Mr McCaw was preparing to list Clearwire on the stockmarket, but then something better came along. Intel, the world's largest chipmaker, announced that it would invest $600m in Clearwire on top of a stake it already owned; and Motorola, a maker of telecoms equipment, said that it would buy the Clearwire subsidiary that makes wireless modems and base-stations. In total, Mr McCaw raised $900m—more than double what the stockmarket seemed ready to give him—and simultaneously made blood brothers out of two technology powers whose support he would have needed anyway. As a bonus, his firm remains unlisted, and he keeps his valued privacy.

But once again, he asks his critics to question their assumptions. Lately, the consensus has been that Intel and other companies were betting too much on what might turn out to be a losing wireless technology. Called WiMAX, this technology promises to provide high-speed internet access, akin to the short-range Wi-Fi technology that is already used in many homes and offices, but over the kind of wide areas usually associated with mobile-phone networks. As well as providing broadband access in rural areas, WiMAX could challenge the duopoly of cable operators and telecoms incumbents. But despite much hype from Intel, WiMAX's main cheerleader, it has taken far longer than expected to get the standards agreed and the technology working.

Clearwire's way around this problem has been to offer a precursor technology to WiMAX that can be upgraded once the technology and standards are sorted out. Its subscribers—100,000 of them so far, in America, Belgium and Ireland—get a wireless modem, which they plug into a computer. The modem is portable, so users can connect from anywhere within a region, but not yet mobile, so users cannot connect from a moving bus. Now flush with cash, Clearwire will buy more spectrum—it already owns more suitable spectrum in America than anybody except Sprint Nextel, a mobile operator—and lots of base-stations from Motorola. Intel hopes to benefit from all this in future by selling WiMAX chips that can be built into laptops.

The trouble is that mobile operators in many countries already provide wireless internet access via their third-generation (3G) mobile networks. Admittedly, these 3G services have fallen short of expectations, exist in two incompatible versions and are not very fast. So they pose little threat to the broadband services offered by cable and fixed-line telecoms firms. But compared with WiMAX, 3G is already widely

deployed, the technology is improving and mobile operators can offer nationwide coverage. Clearwire owns spectrum in only a small number of markets so far, and establishing service in America's 50 biggest cities, the first step towards nationwide coverage, will require a lot of investment in both spectrum and infrastructure. Even so, a battle has erupted between Intel and Qualcomm, an American wireless-technology firm that developed the technology that underpins both versions of 3G, says Russell Daggatt, an executive who has worked with Mr McCaw.

Different, and comfortable

Mr McCaw, with his long industry experience, is used to such risks. He and his three brothers grew up with an adventurous father who bought and sold radio and television stations for fun, and also borrowed liberally. The boys started working for their father—stringing cables, climbing poles—and then inherited a cable company, which Craig ran from his college dormitory at Stanford, and eventually sold in order to concentrate on the wireless market. More recently, Mr McCaw has also ventured into satellites and other risky ventures. But his vision, despite his own retiring nature, of connecting people through the ether has remained remarkably coherent, as has his appetite for risk.

“You have to be driven by competitiveness, which is usually driven by adversity,” he told the Academy that day, a decade ago. As a severe dyslexic, he knows adversity well. Dyslexia compelled him to be “conceptual”, he said, and thus to entertain only big ideas. And it forced him to become comfortable about being different. “I don't think like other people, so I don't fit very well in a clique,” he reflected. In his case, that has made him stronger. “I've never worried whether somebody else thought it was the right thing,” he said. “If I believed it was the right thing, then I was prepared to build it and hoped that 'they would come'.” And so he does to this day.

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Economic models

Big questions and big numbers

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We cannot live without big and ambitious economic models. But neither can we entirely trust them

AMONG the many gadgets, instruments and artefacts in its care, London's Science Museum holds a peculiar contraption that most resembles the work of a deranged plumber. Yellow tubes connect together a number of tanks and cisterns, around which coloured water can be pumped. Sluices and valves govern the flow of liquid and makeshift meters record the water-levels.

The “plumber” responsible for this device was William Phillips. Educated as an engineer, he later converted to economics. His machine, first built in 1949, is meant to demonstrate the circular flow of income in an economy. It shows how income is siphoned off by taxes, savings and imports, and how demand is re-injected via exports, public spending and investment. At seven feet (2.1 metres) high, it is perhaps the most ingenious and best-loved of economists' big models.

Economists today use computers and software not perspex and piping, but they share Phillips's itch to build models that faithfully mirror the real economy. For each of the big economic questions facing the world (What do we stand to gain from a global trade deal? By how much has expensive oil retarded growth? What might be the economic costs of an avian flu pandemic?) there is a model that will provide a big numerical answer ($520 billion, 1.5% of world GDP, and $4.4 trillion, respectively). Such figures are trotted out far and wide. But can we entirely trust them?

Economic models fall into two broad genres. Macroeconomic models, the distant descendants of Phillips's machine, belong mostly in central banks. They capture the economy's ups and downs, providing a compass for the folks with their hands on the monetary tiller. The second species, known as computable general equilibrium (CGE) models, largely ignore the vagaries of the business cycle. They concentrate instead on the underlying structure of production, shedding light on the long-term repercussions of such things as the Doha trade round, a big tax reform or climate change.

Both kinds of model share a debt to Leon Walras, a 19th-century French economist. Walras was adamant that one could not explain anything in an economy until one had explained everything. Each market—for goods, labour and capital—was connected to every other, however remotely. This interdependence is apparent whenever faster car sales in Texas result in an increase in grocery shopping in Detroit, the

home of America's “big three” carmakers. Or when steep prices for oil lead, curiously enough, to lower American interest rates, because the money the Saudis and the Russians make from crude is spent on American Treasury bonds. This fundamental insight moved one economist to quote the poetry of Francis Thompson: “Thou canst not stir a flower/Without troubling of a star.”

Flowers and zombies

Such thinking now comes naturally to economists. But it still escapes many politicians, who blindly uproot flowers, ignorant of the celestial commotion that may ensue. They slap tariffs on steel imports, for example, to save jobs in Pittsburgh, only to find this costs more jobs in the domestic industries that use the metal. Or they help to keep zombie companies alive—rolling over their loans, and preserving their employees on the payroll—only to discover they have starved new firms of manpower and credit. Big models, which span all the markets in an economy, can make policymakers think twice about the knock-on effects of their decisions.

Wassily Leontief was one of the first to do more than just theorise about this tangled web of interdependence. In 1941 he published his book “The Structure of American Economy”, which he updated a decade later. Tucked in the back was a 55cm x 65cm table—too big to be printed in the book itself—showing the flow of commodities and services back and forth among America's households, trading partners and 41 national industries. Of the $5.58 billion-worth of yarn and cloth that passed out of America's factory gates in 1919, for example, $318m was exported, $41m was used up in agricultural production, $31m in making furniture, $6m in the shoe industry, and so on. In Leontief's blueprint, each industry is represented by an equation. The inputs to the industry are entered on one side of the equation, the industry's output appears on the other. Since the output of one industry (steel, for example) serves as an input for another (construction), one cannot solve any equation without solving them all simultaneously.

In the palm of their hands

Short of good data, and stretched to their computational limits, the early modellers nonetheless had high ambitions. They aimed not merely to understand the economy, but to run it. Leontief's book was translated into Russian; his techniques studied by Soviet planners. Leif Johansen, a Norwegian economist often credited with building the first CGE model, put his handiwork to use at Norway's planning ministry. During the second world war, the stewards of America's war effort turned to the Cowles Commission, an economics brain-trust, to help them ration America's resources. “We imagined that we held the well-being of the economy right in the palms of our hands,” one of the Cowles economists told a journalist, David Warsh. One measure of the modellers' prestige is the disquiet they inspired among free-market types. Leontief noted the “unconcealed alarm” among businessmen, who feared that “too close and too detailed an understanding of the structure of the economic machine and its operation might encourage undesirable attempts to regulate its course.”

Such ambitions now seem quaint. In countries not cursed by socialism or war, the market is left to decide what to produce and in what proportions. But the state remains responsible for keeping the overall macroeconomy ticking over. Policymakers are largely indifferent to what is in demand, so long as the tank of demand remains full.

For three decades after the war they carried out this duty with remarkable success, aided and abetted by macroeconomic models in the spirit of Phillips's machine. Empirical economists put a lot of effort into teasing out the historical relationships between macroeconomic variables, such as inflation and unemployment. These measurements were fed into their models, which in turn guided their policy advice.

In 1958, for example, Phillips showed that for long stretches of British history, high unemployment coincided with low wage inflation, and vice versa. Many macroeconomic models therefore featured a trade-off between the two: doves could choose low unemployment at the expense of high inflation; hawks the opposite.

But in the 1970s these trusted relationships broke down. And in 1976 Robert Lucas, of the University of Chicago, explained why. Such trade-offs, he argued, existed only if no one expected policymakers to exploit them. Unanticipated inflation would erode the real value of wages, making workers cheaper to hire. But if central bankers tried to engineer such a result, by systematically loosening monetary policy, then forward-looking workers would pre-empt them, raising their wage claims in anticipation of higher

inflation to come. Cheap money would result in higher prices, leaving unemployment unchanged.

In short, one could not judge how the macroeconomy would respond to a new policy based on its behaviour under the old regime. The “Lucas critique”, as it was called, brought its author fame and a Nobel prize. But it dealt a big blow to the confidence of model-makers. As Christopher Sims of Princeton University has put it, “Use of quantitative models as a guide to real-time policy advice was cast into such deep disrepute that academic research on the topic nearly completely ceased.”

It did not start again until academic economists found new foundations for their models, foundations that would not shift under their feet when policies changed. They located this bedrock in the “microfoundations” of macroeconomic behaviour. Mr Lucas and his disciples, echoing Margaret Thatcher, believe there is no such thing as society. Everything that happens at the level of the economy as a whole is simply the sum of the actions of individual households or firms. If you know how the “representative” firm or household makes its choices, the argument goes, you can forecast how the economy might respond to a policy, even if that policy has never been tried before.

In the past decade, a number of central banks—and even the International Monetary Fund (IMF)—have reared a new generation of practical macroeconomic models, all of them sporting microfoundations. First-born was Canada's Quarterly Projection Model in the mid-1990s; its close siblings include the Bank of England Quarterly Model (BEQM) introduced in 2004; the SIGMA model groomed by the Federal Reserve's International Finance Department; and the IMF's new Global Economic Model (GEM). Old hands doubt whether the new microfoundations are quite as secure as they seem—the macroeconomy is surely rather more than the sum of its parts—but no self-respecting theorist can now be seen in public without them.

Stabilising the macroeconomy is only one of the responsibilities of governments in a market economy. They must also raise taxes and most feel the need to impose tariffs, both of which put rocks in the stream of economic life. When they contemplate big changes to these policies, most governments cannot resist turning to CGE models to forewarn them of the consequences.

These models were, for example, a weapon of choice in the battles over the 1994 North American Free-Trade Agreement (NAFTA). The pact's opponents had the best lines in the debate—Ross Perot, a presidential candidate in 1992, told Americans to listen out for the “giant sucking sound” as their jobs disappeared over the border. But the deal's supporters had the best numbers. More often than not, those with numbers prevail over those without. As Jean-Philippe Cotis, chief economist of the OECD, has put it, “orders of magnitude are useful tools of persuasion.”

Pick a number, any number

But how plausible were the numbers? Twelve years on, economists have shown little inclination to go back and check. One exception is Timothy Kehoe, an economist at the University of Minnesota. In a paper published last year, he argued that the models “drastically underestimated” NAFTA's impact on trade flows (if not on jobs). The modellers assumed the trade pact would allow people to buy more of the goods for which they had already shown some appetite. In fact, the agreement set off an explosion in the exports of many products Mexico had scarcely traded before. Cars, for example, amounted to less than 1% of Mexico's exports to Canada before the agreement. By 1999, however, they accounted for more than 15%. The only comfort economists can draw from their efforts, Mr Kehoe writes, is that their predictions fared better than Mr Perot's. A low bar indeed.

Dubious computations also helped to usher the Uruguay round of global trade talks to a belated conclusion in 1994. Peter Sutherland, head of the General Agreement on Tariffs and Trade, the ancestor of the World Trade Organisation (WTO), urged negotiators to close the deal lest they miss out on gains as great as $500 billion a year for the world economy. This figure came, of course, from a big model.

Even staunch free-traders, such as Arvind Panagariya, an economist now at Columbia University, thought these claims “extravagant” and “overblown”. They escaped scrutiny, he argued in 1999, because they emanated from “gigantic” models, which were opaque even to other economists. Why then did these models thrive? Supply and demand. “Given the appetite of the press and politicians for numerical estimates and the publicity they readily offer researchers, these models are here to stay,” Mr Panagariya concluded.

That appetite was undiminished at the onset of the next round of trade negotiations, launched in Doha,

the capital city of Qatar, in 2001. Two years into the round, as trade ministers gathered for a summit in Mexico, the World Bank was pushing another extravagant simulation. It argued that an ambitious Doha agreement could raise global incomes by $290 billion-520 billion and lift 144m people out of poverty by 2015. Those figures found a ready place in almost every news report about the Doha round that autumn.

Such extravagance did not last. The World Bank has since cut these figures drastically, in part because the ambitions of the Doha negotiators have fallen short of the bank's expectations. One estimate made last year had cut the increase in global incomes to $95 billion and projected 6.2m people might instead move out of poverty. But even as they curb their enthusiasm for Doha, proponents of freer trade argue that CGE models do not show their cause to its best advantage.

Trade's virtuous effects are of two distinct kinds. First, trade helps countries make the most of what they already have. It frees countries to allocate their resources—whether they be cheap labour, fertile land or educated minds—as efficiently as possible. But, secondly, trade can also allow countries to accumulate resources more quickly. Indeed, the biggest prizes lie in faster growth, not heightened efficiency; in accumulation and innovation, not allocation.

By their nature, CGE models are better suited to capturing the first effect than the second. They provide “before and after” snapshots of the economy at two points in time. They are therefore good at capturing the one-off gains that might arrive from a redeployment of the economy's resources. They are much less good at capturing the continuing gains that result from a faster accumulation of capital, or a quickened pace of productivity growth. Most trade models, indeed, hold productivity fixed.

In a recent article, Dominique van der Mensbrugghe, of the World Bank, illustrates the much bigger numbers the modellers could produce given a free hand. He assumes that the very act of exporting raises the productivity of firms, because selling on world markets forces companies to raise their game while exposing them to new ideas and techniques. This alternative assumption raises the gains from free trade in goods by $174 billion (or thereabouts).

These rival assumptions are not right or wrong, but they illustrate how far the results of CGE models flow from the presuppositions of their authors. Most empirical exercises confront theory with numbers—they test theories against the data; sometimes they even reject them. CGE models, by contrast, put numbers to theory. If the modeller believes that trade raises productivity and growth, for example, then the model's results will mechanically confirm this. They cannot do otherwise. In another context, Robert Solow, a Nobel prize-winner, has noted the tendency of economists to congratulate themselves for retrieving juicy plums that they themselves planted in the pudding.

In a recent article, Roberta Piermartini and Robert Teh, two economists at the WTO, urge modellers to “demystify” their creations, making it clear to their audience what makes their models tick. A failure to do this, they argue, “risks bringing a useful analytical tool into disrepute and may even induce unwarranted cynicism about the economic case for open trade.”

To be fair, most modellers are quite open about the theoretical principles that underlie their simulations. But to compute an economic model, this theory has to be given concrete form, spelt out in definite algebraic terms. Alfred Marshall, one of the fathers of neo-classical economics, distrusted mathematics for this very reason. To be expressed in mathematical form, he complained, many important economic considerations had to be “clipped and pruned till they resembled the conventional birds and animals of decorative art.” Economic theory gives only the roughest guide to this pruning. It points out, for example, that supply rises when prices increase. But does it rise in a straight line or curve upwards? Perhaps, as prices rise, supply traces out an inverted U-shape or an S-shape?

Such choices of form matter more than most modellers recognise, argues Ross McKitrick, of the University of Guelph in Canada. In a 1998 paper, he ran two simulations of the Canadian economy's response to a tax rise. The two projections shared the same Walrasian philosophy, used identical data and examined the same 10% tax on the purchase of services; they differed only in the way they clipped and pruned households and companies, giving different mathematical expression to the laws of demand and supply. But these subtleties of expression had profound effects. In the first of his simulations, the tax rise allowed government spending to increase by more than 60%; in the second, spending could rise by just 14%. The first simulation makes the tax sorely tempting to any big-spending Canadian politician; the second much less so. But the policymakers who swallow these simulations have little way of knowing what is driving the results: is it deep theory, solid data, or arbitrary pruning? Sometimes the model-maker himself does not know.

The lost art of plumbing

Phillips's pump-action model was, he wrote, meant for “exposition rather than accurate calculation.” But all models should ultimately be seen as pedagogical devices, their calculations a means to the end of helping policymakers think through their decisions. Unfortunately, Phillips's model was rather better at this than many of its more sophisticated successors. It was transparent: you could see through its casing, trace the flow of expenditures through its pipes and watch wealth accumulating in its tanks. Get things wrong and prosperity drained away in front of your eyes. The model was also easy to tinker with: valves could be loosened, sluices opened and taps tightened. It was clear what was governing its results.

Shantayanan Devarajan, of the World Bank, and Sherman Robinson, of the International Food Policy Research Institute, point out that policymakers need not grasp exactly how a model works, any more than “a pilot needs to understand the insides of a flight simulator.” This may be true. But too many policymakers never even “fly” their models. They just want to know where they will land. If they were instead prepared to work through the simulations they might find inconsistencies in their thought, unforeseen implications of their policies, or new reasons for their actions. The big number that sums up a model's story—$520 billion, 1.5% of world GDP, $4.4 trillion—is often the least interesting thing about it.

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Global markets

Tightening the reins

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Investors should beware the tug of higher interest rates

CENTRAL bankers in the world's big, rich economies have played a frustrating guessing game with financial markets this year. But if there is one thing about which investors can be more or less sure, it is that for the first time in years, official interest rates in America, Europe and Japan are heading in the same direction.

The European Central Bank has dropped a heavy hint that, having lifted rates in December, March and June, it will do so again on August 3rd. Its governing council will meet in person that day rather than by telephone, its August custom. Policymakers at America's Federal Reserve may wish that they could give the markets a summer break, having raised the federal funds rate to 5.25% on June 29th, the 17th increase in as many meetings. The markets, however, are not expecting a rest. Non-farm payrolls grew less in the second quarter than in the first, but hourly earnings rose in June at their fastest year-on-year pace since 2001. Enough inflation apparently lurks in the American economy for traders to expect another quarter-point rise when the Fed's rate-setters meet on August 8th. And as *The Economist* went to press, the Bank of Japan (BoJ) seemed likely to complete the pattern by raising interest rates above zero on July 14th for the first time since 2000, probably to 0.25%.

In Japan and Europe higher rates will, for the time being, be only gentle tugs on the reins as their economies gather momentum. In America, where growth has been brisk for years, monetary policy is stronger, but not yet a yank on the bridle. Yet the prospect of an end to a long era of easy money has put financial markets into a lather. After the BoJ turned off the monetary printing presses in March and began to drain ¥20 trillion ($175 billion) of excess liquidity—the equivalent of 4% of GDP—from the banking system, the Japanese stockmarket dropped violently. And global investors reconsidered their appetite for risky investments, retreating from overheated economies such as New Zealand, Saudi Arabia and Iceland.

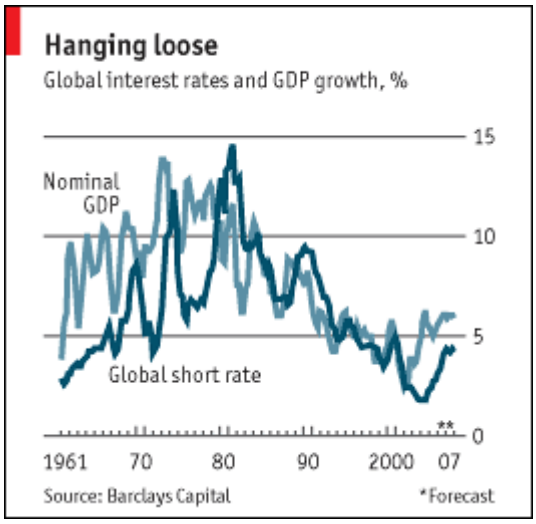
In May concerns about how the Fed, under a new chairman, would handle the live wires of slowing growth and rising inflation caused a month-long drop in global equity and commodity markets. Uncertainty, especially about global interest rates, made financial markets of all sorts turbulent in May and June.

The jumpy reaction was understandable. For years, loose money has lubricated markets and encouraged consumers, companies and speculators to borrow handsomely. Recently Japan, with interest rates at nil, has provided much of the liquidity. Japanese investors have bought high-yielding assets abroad to beat the miserable returns at home. Meanwhile, global hedge funds have borrowed in yen and invested profitably in anything from emerging markets to high-yield debt.

A few years ago, they did the same with the dollar. When American interest rates were as low as 1%, there was money to be made by borrowing greenbacks and buying higher-yielding currencies such as the Australian and New Zealand dollars. But as interest rates rose, the dollar lost its lure as a funding currency, and speculators switched to yen. With Japanese interest rates now heading up as well, such investors may have to think of a new game.

So far, however, there are few signs that they are dumping non-Japanese assets and switching back into yen. There are no reliable data on the size of the yen “carry trade”, but if it were to unwind, the yen would surely rise. It has not done so yet. Also, with inflation back in positive territory, real interest rates in Japan are still negative and short-term rates are not expected to rise above inflation until next year. Until that happens, brokers expect little let-up in the appetite of Japanese institutional investors for high-yielding assets.

What of rising interest rates elsewhere? Will these prick the liquidity bubble? Probably not for the time being, says Barclays Capital, an investment bank. It notes that global interest rates are still well below nominal GDP growth (see chart), whereas throughout the inflation-busting 1980s and 1990s they were mostly higher. That suggests monetary policy is still pretty loose. Barclays Capital believes that interest rates will have to rise further to quell inflation. It thinks America's fed funds rate will end the year at 6%.



Financial markets may still react in an orderly way to such an outcome, if the risks of a hard landing or an inflationary spiral do not materialise. On the other hand, the sell-off in May and June may be a dress rehearsal for what is in store if concerns about the global economy mount.

The Old Lady's word of warning

On July 12th the Bank of England gave a taster of what might happen if things do not go according to plan. In its half-yearly *Financial Stability Report*, it noted that for the first few months of 2006, higher interest rates did not make risky investments less popular, as they normally should.

Instead, prices of the most speculative investments kept rising. Rewards for holding the riskiest bits of collateralised debt obligations (pools of debt often bought by hedge funds) fell sharply until April. Spreads on emerging-market debt fell to levels at which, just three and a half years before, those on investment-grade corporate bonds had stood. Emerging-market share prices rose by 30% between December and May.

Such gains vanished quickly in the May and June turmoil, but the sell-off was not devastating—merely a healthy correction, thinks the Bank of England. Share prices are roughly where they were at the start of the year. Credit markets are buoyant. Private-equity groups around the world are raising vast funds, and companies are increasing their levels of borrowing.

The bank says the market's benign attitude to risk may simply reflect a more secure financial world. But it might also indicate complacency. If investors turn away from risk, prices will fall sharply, and supposedly liquid portfolios will suddenly become hard to sell. Too much new borrowing could put companies at risk if the credit cycle turns. Banks may be putting too much of their own capital into trading and blundering into risky activities just to show that they have a presence.

One of the central bank's main concerns is that investors see this spring's events as a blip and charge straight back into the most volatile assets. Perhaps they already have. Michael Metcalfe of State Street Global Markets, a big asset-management company, notes that investors are buying cross-border assets again this month after abandoning them in June. Provided they do so selectively, that is fine. But if the

tightening continues, bravery may soon look like folly.

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Rating agencies

Downgraded

Jul 13th 2006 | NEW YORK
From The Economist print edition

After decades of being unable to define rating agencies, America's Securities and Exchange Commission may gain the right to oversee them

FOUR years into a vigorous economic expansion, it is striking how little confidence America's politicians have in the country's businesses and capital markets. New rules have been imposed on how investment banks underwrite and provide opinions on shares, resulting in less equity underwriting and fewer opinions. Compliance with the numerous provisions of the Sarbanes-Oxley act is costing public companies large sums and prompting some to go private.

Having narrowly escaped inclusion in these efforts at regulation, credit-rating agencies have now been roped in. On July 12th the House of Representatives approved what, if backed by the Senate, should become the Credit Rating Agency Duopoly Relief Act. The title alone tells you one of the bill's intentions: to erode the vast market share of the two big agencies, Moody's and Standard & Poor's (S&P). More important, it will transform the agencies from ventures publishing comments that enjoy the first amendment's protection of free speech into wards of the Securities and Exchange Commission (SEC) that must subject their opinions to regulatory review.

That this is happening says more about Congress than about either the agencies or financial markets. Although Moody's and S&P have been far from perfect at evaluating debt, reams of statistical studies show they have at least some skill in predicting which companies will go bust. Overall, banks and investment firms find them useful, either as an indicator of credit quality or as a benchmark to bet against. In the teeming market for opinions, they hardly have a duopoly.

The signature failure cited by the big agencies' critics is that neither predicted the financial wreckage of Enron and WorldCom. Both maintained investment-grade ratings until the demise of the companies was plain. That said, the agencies relied on financial statements that were later found to be fraudulent—which reflects at least as badly on the SEC's ability to police its own filings as on the analytical ability of the agencies. And in the myriad investigations that followed the collapses of Enron and WorldCom, neither Moody's nor S&P was found to have acted wrongly. Some financial institutions already under the supervision of the SEC may wish they could say as much.

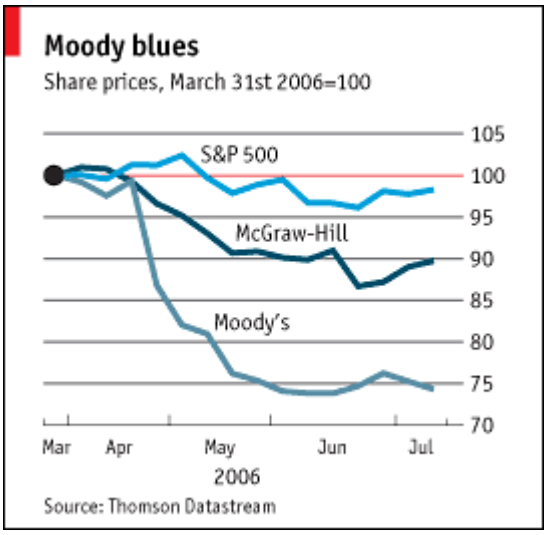
As it happens, there is good reason to change the rules covering rating agencies, by stripping away the protection granted to the biggest of them by the SEC in 1975—the history of which is a good example of the unintended consequences of regulation. At the time, the SEC granted a broker's request to use the bond ratings of Nationally Recognised Statistical Rating Organisations (NRSROs) in determining how much capital it required. The idea of using ratings from leading agencies for regulatory purposes was then applied to a number of other tasks, such as determining which securities could be included in money-market funds and the investment portfolios of insurance companies and state pension funds.

That gave the ratings of the NRSROs added value. At first, just three were recognised: Moody's, S&P and Fitch. Others were added later, but then merged with Fitch. Many more tried to gain recognition, but only two succeeded: Dominion Bond Rating Service in 2003 and A.M. Best in 2005. Remarkably, in the three decades since the NRSRO tag was first used, the SEC has never defined what is required to get it, thus creating a clear barrier to entering the rating business. This enraged a small Pennsylvania agency named Egan-Jones. Its plight touched a chord with Michael Fitzpatrick, a congressman from that state, who introduced this week's bill.

Mr Fitzpatrick's bill would do away with the entry barrier. All well and good: even Moody's supports the end of its regulatory franchise, and S&P has argued against embedding a similar scheme in the Basel 2 rules on banks' capital. It makes little sense for an agency to be endorsed by grant of the SEC, rather

than by the market's assessment of its opinions.

Under the new legislation, however, the system will not be killed. It will merely be broadened and made more bureaucratic. Any firm with three years' worth of ratings can be recognised, provided it registers with the SEC, provides bucketloads of paperwork, sets out its procedures, and agrees to sanctions if the SEC subsequently decides these procedures have not been followed. The SEC, in short, will soon be in the business of rating the raters and how they follow their own rules. Smart investors will ignore the lot and simply pay attention to firms that have perceptive things to say.



Clearly, the changes will not be beneficial to Moody's and S&P. At the least, their autonomy will be curtailed. The share prices of Moody's and McGraw-Hill, S&P's parent, have fallen—Moody's, markedly (see chart). But will they be the only losers? Some limitations have been placed on the ability of outsiders to sue the agencies, but the protection is not absolute. Consumers of credit information may take some solace in the notion that the SEC is reading over their shoulder, but that would be a mistake. Under the new rules, the SEC will review methods. Expect that only after disaster strikes. If the SEC truly thought it could evaluate credit, it would do the job itself.

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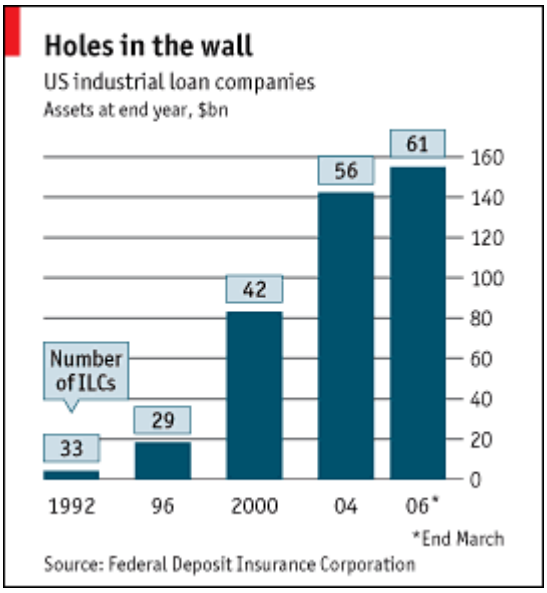
America's industrial loan companies

Keep out

Jul 13th 2006 | NEW YORK
From The Economist print edition

Congress tries to strengthen the barrier between commerce and banking



WAL-MART has a way of upsetting people. So it was no surprise that the giant American retailer's plan to set up a bank, announced last year, met noisy opposition. Now debate may be turning to action. On July 10th a bill was introduced into the House of Representatives that would quash Wal-Mart's aspirations by prohibiting non-banks from buying or forming industrial loan companies (ILCs). Several commercial firms run banking businesses through ILCs; several more, including Wal-Mart, hope to do so.

At a committee hearing on July 12th Scott Alvarez, general counsel of the Federal Reserve, gave warning that the proliferation of ILCs in recent years (see chart) was eroding America's 50-year-old regulatory wall dividing banking and commerce. The bill seeks to strengthen the wall by preventing the Federal Deposit Insurance Corporation (FDIC), the bank regulator that oversees ILCs, from granting charters to companies that derive more than 15% of their profits from non-financial activities.

This would rule out a Wal-Bank. It would also thwart Home Depot, a large DIY chain that said in May it was buying EnerBank, an ILC that provides home-improvement loans, and some other companies with applications pending. Existing ILCs chartered after October 1st 2003 would be restricted too, for instance by a ban on opening branches across state lines. The bill also gives the FDIC broader regulatory powers, including the authority to scrutinise not just an ILC, but also its (commercial) owner and affiliates.

Even if the bill gets through the House, it faces a fight in the Senate. Still, Floyd Stoner of the American Banking Association, a trade group that is critical of ILCs, is optimistic: “Reform always takes time—but the debate in Congress is a sign that the process has started.” Some states have already headed in this direction. California and Colorado passed laws in 2003 barring non-banks from owning ILCs. Five states have passed rules that, in effect, bar non-bank ILCs from opening branches. Similar legislation is pending in six other states.

According to those against non-banks owning ILCs, mixing banking and commerce could distort lending. A non-bank owner could use its banking subsidiary's deposits (which, through the FDIC, are insured by the taxpayer) as a source of cheap finance. In particular, suppose that the parent company got into trouble. It might borrow from the ILC to shore itself up. Alternatively, the ILC's customers could take fright at the parent's difficulties and pull out their deposits in a hurry. What, ask the bill's supporters, would have happened had Enron owned a bank?

Others think these fears overblown. In America's competitive financial industry, a bank's ability to discriminate in its lending is limited. Moreover, federal rules that limit the amount banks can lend to their affiliates are already on the books.

Those who see no reason why non-banks should not own ILCs say bankers' real fear is competition, especially from Wal-Mart and Home Depot. Although Wal-Mart insists it would use an ILC only to save money on processing its credit-card and debit-card transactions, bankers fear it will eventually enter branch banking. Already, the retailer cashes cheques, sends money orders and so forth, often much

more cheaply than competitors do. In Massachusetts bankers are fighting Wal-Mart's attempts to start cashing cheques in the state. And the customers? Too bad.

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Securities trading

Only connect

Jul 13th 2006
From The Economist print edition

European officials think it should be cheaper to clear and settle share trades

BY FUSING lots of national markets into a continental whole, the European Union is supposed to make all sorts of goods and services cheaper for the citizens of its member states. In some industries, however, practice lags a long way behind theory. In one of these, financial services, Charlie McCreevy, the EU's internal-market commissioner, is determined to hurry matters along. On July 11th he fixed on the cross-border clearing and settlement of trades in shares, with an eye to lowering the cost of dealing in them.

Europe's financial exchanges cling to different models for clearing and settlement: Deutsche Börse, for example, controls the entire operation from top to bottom; the London Stock Exchange (LSE) and Euronext, which owns the Amsterdam, Brussels, Lisbon and Paris bourses as well as the LIFFE derivatives exchange, have their trades cleared by another firm, LCH.Clearnet, in which both own stakes. They have separate settlement deals. Mr McCreevy offers no uniform prescription for change, saying only that clearing and settlement should become more transparent and competitive by the end of next year. If not, he may take a firmer line.

Mr McCreevy's market-led approach is partly a nod to reality. Changes already under way will reshape Europe's financial markets faster than a new directive could be drafted and adopted. The biggest changes could come from a directive known as MiFID, which takes effect from November 2007 and which will bring an end to monopolies in share trading. MiFID will require, among many other things, that European investment firms have access to clearing and settlement in other member states. A trade could therefore be cleared and settled by operators unconnected with the exchange on which the share was listed.

Exchanges with vertical “silos”, such as Deutsche Börse, are under most pressure to reform. They are, however, defending themselves stoutly. Deutsche Börse insists that its prices are already transparent. It also says that the European Commission's estimate of its costs (see chart) is much too high. The Italian and Spanish exchanges (the latter is floating its shares on July 14th) also use vertical models. Despite this, Massimo Capuano, chief executive of the Milan exchange, claims that his bourse has Europe's lowest total trading costs.

A new wrinkle in the story emerged recently when the European Central Bank (ECB) said it would explore the possibility of creating its own pan-European settlement platform. The idea came with few details, but raised some eyebrows. For a central bank to own such an operation would be highly unusual. More than one market observer suggested that the ECB's statement, which Mr McCreevy's officials applauded, was intended primarily to concentrate the minds of the fragmented European market in post-trade services.

Evidence of impatience with the state of such services came last week with the resignation of David Hardy, chief executive of LCH.Clearnet. Mr Hardy had faced criticism from his board and shareholders for delays in the integration of two once-independent businesses and because promised cost savings have not come through. A spokesman for Euronext says that it intends to cut its stake in LCH.Clearnet from 41.5% to 24.9%, but notes that the clearing firm “needs to get its house in order” before anyone will buy. The LSE has signed an agreement with a Swiss clearing house that it says will give its users an alternative from 2007.

Adam Kinsley, who specialises in regulation at the LSE, says that Europeans look with some “jealousy” at America, which has cheaper, unified share-clearing operations that benefit from scale. Even so, he says, it is probably better for Europe to have two or three providers, rather than one, because of potential difficulties with corporate governance and “systemic risk”.

MiFID's rule that trades may be cleared and settled anywhere is another argument for consolidation. With fewer clearers and settlers, it would be easier for everyone to link to everyone else—and trading should be smoother and cheaper.

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Death and disgrace insurance

Reputational risk

Jul 13th 2006
From The Economist print edition

Limiting the damage when stars' images are tarnished

HEAD-BUTTING, stamping, insults, feigning injury: in too many ways, the FIFA World Cup darkened the image of those who play the beautiful game. Football is not alone. Witness the allegations of doping that removed top cyclists from the Tour de France and the talk of performance-enhancing drugs that swirls around baseball. Errant stars may worry about more than just a ban from the field or the saddle. Some earn as much from endorsements as from competing, and sponsors dislike seeing their brands dragged down.

Just how anxious the sponsors are, though, depends both on the reputation of the stars flogging their goods and on whether they have taken financial precautions. They can limit damage from appalling behaviour (or worse) in the form of “death and disgrace” insurance, available for a fee of roughly 0.5-1% of the designated payout.

Reuters

Heading for trouble

Collecting on such policies can be tricky. Although death is easy enough to prove, disgrace is more subjective. “The more squeaky clean someone's image is, the more that can go wrong,” says Robin Walsh, of Hiscox, a syndicate at Lloyd's of London that writes death and disgrace policies. The history of bad behaviour on and off the football field suggests that few World Cup miscreants, if any, are likely to lose endorsement contracts.

Potentially more damaging, industry observers say, is the blood-doping scandal that has hit the Tour de France. Stars such as Jan Ullrich of Germany, Ivan Basso of Italy and Francisco Mancebo of Spain have been removed from the competition after being implicated. They deny doing wrong. Although individual cyclists rarely have sponsorship deals on the scale of footballers', the backing of entire teams is at stake. Companies such as Würth, a German hardware firm, have already cancelled team sponsorships.

Of course, celebrity endorsements extend well beyond sport. Kate Moss, a British model who lost several contracts after being suspected of illegal drug use, shows how a bad-girl image can be turned to advantage, having bounced back with new endorsements.

“Some people are like Snow White and others you feel can get away with murder,” says Adrian Thomas, of Aon, a big insurance broker. Well, maybe not literally. It is hard to shake off the sort of publicity that surrounded O.J. Simpson, an American football star turned actor who fronted advertisements for Hertz car rentals. Mr Simpson was charged with murder in 1994. Acquitted of criminal charges, he was convicted of wrongful killing in a civil trial. By then, the sponsors had long since pulled out.

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Economics focus

Is our children learning?

Jul 13th 2006
From The Economist print edition

After $12 billion of World Bank money, and the promise of more to come, donors still don't really know

> A lot of turtles lived on the bank of a big lake. Boys would go to the bank and look at the turtles. Sometimes the turtles would walk around and at other times retreat into their shells, as if they were stones. On seeing this, the boys would laugh loudly and clap. They would go home and tell everyone the story of the turtles.

NOT the most thrilling narrative perhaps, but less than half of Indian schoolchildren between the ages of seven and 14 could read this passage in their native language even if they wanted to. That was one discouraging result of a national study of literacy and numeracy published by Pratham, an educational charity, earlier this year.

Education for all is a popular cause. So popular, indeed, that every decade or two, governments and donor agencies promise to put all the world's children in primary school by some date, normally ten or 15 years hence. In 1990 they set a deadline of 2000. In 2000 they set one of 2015. All that is required, the donors say, is money and will.

The money may be forthcoming. In April Gordon Brown, Britain's chancellor of the exchequer, promised to spend $15 billion over the next ten years to help realise this goal. Russia, which is hosting the G8 summit in St Petersburg between July 15th and 17th, has put the subject on the agenda and $7m of its money on the table. But throwing money at the problem is not unprecedented. Since 1990 the World Bank has spent over $12 billion on primary education. What has it accomplished? This week its Independent Evaluation Group (IEG) gave its verdict.

Many more children are going to primary school. In the 12 countries the IEG studied in depth, enrolment rates rose by an average of 19 percentage points over the past ten to 12 years. In 1996 Uganda abolished fees for primary education. As a result, enrolment almost doubled in a year, according to official figures (which some scholars distrust). Both Kenya and Ghana have since followed Uganda's lead.

Cutting fees is now touted as a “quick win”, one of precious few easy victories in development. Indeed, far from charging people to attend school, some governments, with donors' help, now bribe them to enrol. They offer free meals or cash handouts to parents on the condition they keep their children in school. In Nicaragua, the IEG reports, a pilot programme along these lines raised enrolment rates by about 22 percentage points.

Governments and donors have been remarkably successful at getting children into school. But what do they learn when they are there? Pratham's study in India is one of few serious attempts to find out. Only five of the 12 countries visited by the IEG had carried out repeated, standardised tests to monitor their progress in educating pupils, rather than merely enrolling them. Parents cannot fill this gap. Their children are often the first members of their family to get an education. As a result, parents do not know what to demand from their schools. In Uttar Pradesh, a state in India, 41% of children could not read a single paragraph, but only 21% of parents think their offspring cannot read.

Uganda's explosive increases in the quantity of schooling came at the expense of an implosion in quality. Three years after the big bang of 1997, for example, the Bundibugyo district of Uganda had 209 pupils for every classroom. In 2005 there were, on average, three students per textbook in the country.

Faced with ratios like these, the obvious response is to build more classrooms and print more textbooks—

in other words, to increase the “inputs” to education. In Uganda the obvious response is probably the right one. But it may not be sufficient. In the past few years trials have shown that simply spending more on textbooks, flipcharts or extra teachers does not necessarily raise test scores for the average pupil.

But these scholarly results rest uneasily with donors' habits. On the whole, they are better at procurement than at pedagogy, better at school-building than schooling. In Peru the bank helped to improve buildings, distribute textbooks and provide training. But Peru's teachers remained ill paid, poorly motivated and barely supervised, and were rarely held to account. Some refused to use free textbooks, preferring to collect commissions from commercial publishers for assigning their books instead.

Learning how to teach

Pratham's response to widespread illiteracy and innumeracy was to experiment. It tried various remedies in half the schools in a district or city, picking which half at random. The remaining schools provided a control group with which to compare the results of its efforts*. One of its more successful ventures was to hire unqualified high-school graduates to provide remedial education for students falling behind. These *balsakhis* (which means “children's friends”) were cheap, paid about $10-15 a month, and quick to train, receiving only two weeks of prior instruction. Because they did their work in hallways or even under trees, there was nothing for governments or donors to build.

Nonetheless, the instruction they offered was surprisingly effective. In Mumbai it raised the chances of fourth-year pupils grasping first-year maths by 11.9 percentage points. It improved their chances of mastering second-year literacy by 9.9 percentage points. The gains in Vadadora (formerly known as Baroda) were smaller, but still worthwhile.

Pratham's remedy may not apply to Africa, where fully trained teachers are still relatively cheap. But the charity's approach—measure, experiment, evaluate—should. Thanks to the *balsakhis*, more of India's children are learning to count and read—well enough at least to enjoy turtle stories. Whether donors are also learning any lessons remains to be seen.

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* “Remedying Education”, by Abhijit Banerjee, Shawn Cole, Esther Duflo and Leigh Linden. NBER working paper 11904, December 2005.

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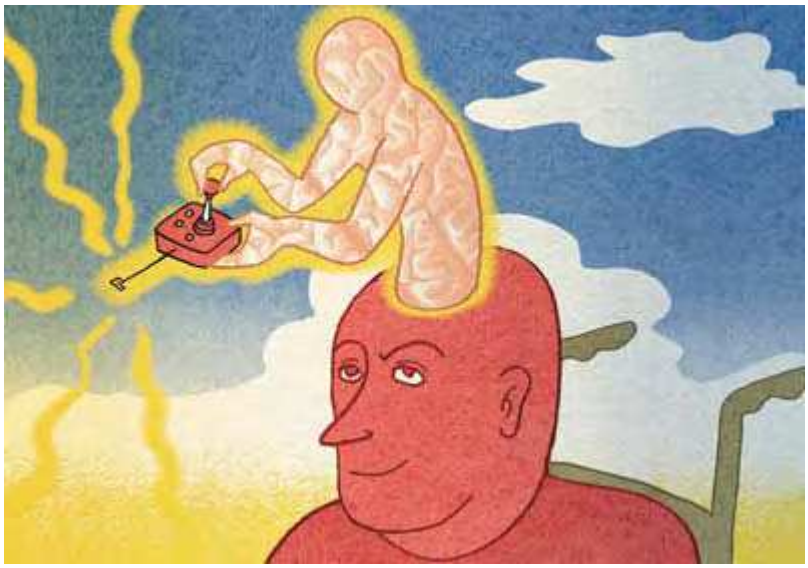
Neuroscience

Converting thought into action

Jul 13th 2006
From The Economist print edition



Two newly published studies show how imagined movements can be made real

MOVING objects by thought is the stuff of science fiction. If a way could be devised to turn fiction routinely into fact—harnessing a person's thoughts to manipulate a computer or move an artificial limb—the consequences could be huge. It would allow paralysed people to lead more independent lives. It might even create opportunities for the able-bodied—particularly those, such as military pilots, who have to handle a lot of complicated things at once.

Two studies published in this week's *Nature* may bring this sort of telekinesis a step closer. In one, John Donoghue of Brown University in Rhode Island and his colleagues describe how a man who is almost completely paralysed is able to use his thoughts, gathered by an electronic implant in his brain, to operate devices including a robotic hand. In the other, a team led by Krishna Shenoy of Stanford University has outlined a new approach to reading brain signals that might dramatically improve the speed at which such manipulation is possible.

Action at a distance

Dr Donoghue's group worked with a 25-year-old man (known as MN, to preserve his anonymity) who had been stabbed in the back three years earlier. The injury severed his spinal cord and left him unable to move his arms and legs. Although he can shrug his shoulders and move his head, he needs help to breathe.

To record his thoughts, the researchers implanted a device called a BrainGate (manufactured by Cyberkinetics, a company spun off from the university) in his skull. This sensor consists of a piece of silicon less than half a centimetre across, fitted with an array of 100 gold electrodes each thinner than a human hair. The other end of each electrode is attached to a nerve cell, so that the BrainGate can sense the activity of 100 nerve cells simultaneously.

The researchers placed the sensor in MN's primary motor cortex, the area of the brain responsible for voluntary movement. Wires from the silicon chip connected each electrode to a plug sitting on top of his

head, and a cable attached to this plug transferred data from the wires to a computer for analysis.

Over the course of nine months, MN took part in 57 sessions. In each, he was first asked to imagine doing a particular task. During this imaginative period the BrainGate fed the electrical activity of its century of nerve cells to a piece of signal-processing software that looked for patterns. Then, once the software thought it could recognise what he wanted to do, MN tried to do it for real.

In most sessions, after just a few minutes of learning how to operate the system, MN was able to do things such as opening pretend e-mail, playing Pong (a simple computer game) and changing the channel and volume of his television set. It became so easy that he could do all this while holding a conversation.

The researchers then connected the output from his brain to a prosthetic hand. MN could open and close this hand at will. When attached to a second robotic device, he was able to pick up a boiled sweet and drop it into a technician's hand.

Besides its obvious applications, one of the most important things about this study from the point of view of those already disabled by spinal injury is that activity had persisted in MN's primary motor cortex for three years after he was paralysed. Some researchers had expected that the brain's function would alter dramatically after the spinal cord was injured, causing this part of the motor cortex to atrophy.

Dr Donoghue and his colleagues are now using the BrainGate system in a 55-year-old man, the second participant in their study. There are still some technical difficulties to sort out. Both trials have reported a loss of signals many months after the implant was made and the reasons for this are not yet known. Another problem is that implanted devices, particularly those with wires penetrating the skin, leave the recipient prone to infection. Wireless communication must be developed if the system is to work outside the sterile conditions of a hospital. Nevertheless, the researchers argue that their implanted system is faster and more accurate than using non-invasive devices, since sensors that rest on the scalp measure only the average activity of millions of nerve cells, blurring the signal.

Dr Donoghue hopes to develop the invention to the point where thought-controlled wheelchairs can be built. He also wants to help people whose injuries are less severe than total paralysis, giving them the ability to operate devices that allow breathing, bladder control and bowel movements. His eventual goal is to link the system with a muscle stimulator that could allow paralysed people to walk.

Take a letter, Miss Moneypenny

Dr Shenoy's work aims to improve a trick already available to those who are severely disabled. People who cannot talk but can move their eyes have, for some time, been able to compose messages by looking at a menu of letters and common words. The machines that allow them to do this sense their eye movements, and thus work out what they are looking at. But the process is frustratingly slow.

Dr Shenoy hopes to speed things up using an implanted sensor similar to Dr Donoghue's. He is not yet ready to try it in people, but he has been conducting experiments on monkeys. He and his colleagues trained two rhesus monkeys to follow a moving target on a computer screen. They then implanted sensors in each monkey's dorsal premotor cortex, a part of the brain that tells the motor cortex what to do. By studying the activity of nerve cells in this area, they were able to predict where the monkeys intended to move before the movements were actually made. They could also predict where the monkeys wanted to move, even when the animals were restrained and no real movement was possible.

Such predictive power could, they think, speed up the rate at which letters are chosen and words formed by those attempting to type by eye. Dr Shenoy believes his method will be capable of generating 15 words a minute, substantially faster than is possible at present.

Whether those who are healthy will want their capabilities enhanced in these sorts of ways remains to be seen. But controlling machinery merely by thinking about it might prove attractive to some. Perhaps the age of the cyborg is closer than most people had thought—except writers of science fiction, of course.

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About sponsorship

Psychedelic drugs

The God pill

Jul 13th 2006
From The Economist print edition

Hallucinogens induce lasting spiritual highs in the religious

ONE June night in Mexico in 1955, Gordon Wasson, a vice-president of J.P. Morgan, became one of the first outsiders to eat what the Aztecs called *teonanácatl*, the flesh of the gods. Actually, it is the flesh of a fungus, and it soon became known to hippies as the magic mushroom. But, whereas the flower children of the 1960s and their descendants gobbled the hallucinogenic fungi in search of a good time, the Aztecs had a deeper purpose. They used the mushrooms in religious ceremonies for healing, divination and communing with the spirit world.

Now a study led by Roland Griffiths of Johns Hopkins University, and published this week in *Psychopharmacology*, has shown that psilocybin—the active component in magic mushrooms—does indeed induce mental states akin to the highest religious experiences. Moreover, it has lasting positive effects on those who take it.

Experiments involving drugs of any kind need to have a control—that is, an otherwise identical experiment in which something other than the drug is administered—to check that any effects are caused by the drug and not something else. Ideally, neither experimental subjects nor researchers should know who is in the control group, but for experiments involving psychedelic drugs this is difficult, because it quickly becomes apparent who is high and who is not.

For his control, Dr Griffiths decided to use methylphenidate hydrochloride, otherwise known as Ritalin, a drug that calms hyperactive children. On one of two occasions, he gave 36 volunteers who had never taken hallucinogenic drugs either psilocybin or Ritalin, swapping the drugs on the second occasion. The choice of Ritalin was inspired. Neither the volunteers nor the experimenters could say reliably which drug was being administered on which occasion.

A close eye was kept on the volunteers for eight hours after the drugs were given, to check all was well. They were then asked about their experience. Two-thirds of the participants, who were mostly middle-aged college graduates, ranked being given psilocybin as either the best or in the top five best experiences of their lives—on a par with the birth of a first child. They described feeling peace, intense happiness and a sense of the unity of all things.

The participants were no strangers to spiritual highs. Almost all engaged at least monthly in religious or spiritual activities such as prayer or attending religious services, and were selected for participation in the trial on this basis. Yet two months after the trial, 79% of them reported moderately or greatly increased well-being or satisfaction. Their positive changes in attitudes and behaviour were confirmed by independent assessments made by friends and family.

Why this should be is not yet well understood. Psilocybin is thought to work by mimicking serotonin. This is one of the messenger molecules that carry signals between nerve cells in the brain, and it is known to influence mood. But there has been little research of late. Clinical studies using psilocybin and other hallucinogens were halted when recreational use of the drugs took off. They have only just resumed after a four-decade hiatus.

Dr Griffiths and his colleagues argue that the mood-lifting effects of hallucinogens might be used to treat drug and alcohol addiction. Psilocybin itself is not addictive, although they recommend that its availability should continue to be limited. Psychedelic drugs could even be used to probe the basis of consciousness, according to Solomon Snyder, one of Dr Griffith's colleagues. Dr Snyder believes that investigation of such drugs could help scientists understand the molecular changes in the brain that underlie religious experiences.

Back in the 1950s, Gordon Wasson spent years gaining the trust of Amerindians who had continued the religious traditions of their pre-Columbian ancestors. Eventually he was allowed to partake of the mushroom. His experience, from which he said he emerged awestruck, started a short period of study that ended prematurely because of the mushroom's widespread recreational use. By showing it is possible to conduct such research responsibly, Dr Griffiths has opened the door for further work to be done on the properties of psychedelic drugs.

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Africa@home

Coming down to Earth

Jul 13th 2006
From The Economist print edition

Linking up computers to defeat malaria

IF MANKIND ever makes the acquaintance of an extraterrestrial alien, the chances are that first contact will come through a humble desktop computer. The SETI@home project, which searches for signs of intelligent broadcasting among the natural radio signals coming from the sky, depends for its computing power on the spare capacity of a zillion small, private machines around the world.

Although SETI@home may or may not find what it is looking for, it has unarguably started a fashion. Donating spare computer cycles to worthy causes is a cheap way of helping those who cannot afford huge piles of hardware to achieve their goals. The latest organisation to take advantage of this is one of the most worthy of all. Africa@home aims to use that spare capacity for no less a task than the defeat of malaria, a disease that kills more than 1m people a year.

Africa@home is a collaboration between the Swiss Tropical Institute, CERN (a big particle-physics laboratory also based in Switzerland) and a group of universities, including three from Africa. Its aim is to develop a long-term model of malaria epidemiology, which it can use to test different ways of combating the disease.

The institute already uses models to study the short-term dynamics of malaria transmission. However, the computing power needed to generate accurate long-term results is beyond its means. Which is where CERN comes in. Besides studying the fundamental nature of reality, the laboratory is also a huge computing centre. Indeed, it is where the world wide web was invented. And, in the wake of the web's success, it has maintained an interest in how to link up lots of small computers so that they can perform tasks beyond most large ones. Long-term epidemiology is an excellent example of such a task.

Using CERN's tools, the universities have devised a program called MalariaControl.net, which takes the institute's model and converts it into a form that can be scattered meaningfully across hundreds—or even thousands—of computers. MalariaControl.net can handle a lot of different sorts of variable, from the changing density of parasites within a human host as an infection progresses to the sort of treatment available in different places around the continent. It also looks at the relationship between parasite density in people and the rate at which humans transfer those parasites back to the mosquitoes that carry them. It can even take account of the time of year, and thus the amount of standing water around for mosquitoes to breed in. Using these variables, it can then predict the result of deploying various drugs, the likely success of methods such as insecticide-covered bed nets that are used to block transmission of the disease, and the probable impact of a vaccine, if and when one becomes available.

A test run using 500 computers has just been completed successfully and the project is now being opened to 1,000 more volunteers (the Africa@home website is accepting registrations). Those volunteers will be able to bask in the knowledge that they are helping to create a cheaper and longer-lasting way of dealing with one of the world's biggest killers. That should be some compensation for not being the first to contact little green men.

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Garment technology

Closing the circle

Jul 13th 2006
From The Economist print edition

Automated tailoring comes closer

THE industrial revolution began with the automation of the textile industry, but never quite managed to finish what it started. Despite advances in the spinning of thread and the weaving and cutting of cloth that have been made in the past 250 years, almost all garments are still assembled and stitched together by hand.

Partly, that is because hands have remained cheap in some places and the cost of transporting their products has dropped enormously. Partly, though, it is because designing automated replacements for human tailors is hard. But a group of European firms and research organisations hopes to change that. Collaborating under the banner of the Leapfrog project, they are trying to complete the process begun in the 18th century by James Hargreaves and his Spinning Jenny, and they hope to have a pilot production line ready by this time next year.

One of Leapfrog's most important tasks is to find ways of grasping and manipulating fabric without damaging it. That job has been delegated to Rezia Molfino of the Laboratory of Design, Measurement, Automation and Robotics at the University of Genoa, in Italy. Dr Molfino is trying three approaches. The first is straightforward: vacuum suction pads. The other two are more unusual. One employs a thermoelectric phenomenon, called the Peltier effect, to cool the graspers handling the cloth (and thus the cloth itself) well below zero by passing current through them. Cooling cloth this way makes it more rigid and easier to control.

Dr Molfino's second unusual approach involves flat surfaces that grasp the fabric they are manipulating much as geckos stick to ceilings. Geckos' feet are covered with microscopic hair-like projections that stick electrostatically to anything they touch. Dr Molfino plans to employ the technology used to etch computer chips to create similar surfaces on her graspers.

Once the problem of handling fabric has been solved, the next question is how to sew it into the right shape. Dr Molfino is working with Philipp Moll, a German sewing company, and STAM, an Italian engineering-research firm, on mannequins that change their size and shape to suit the garment being made.

Details of exactly how these high-tech tailor's dummies work are closely guarded, pending patent protection, but the basic idea is that a network of actuators inside the dummy will push and pull a flexible outer shell into different shapes. The dummy will then be used as a template to locate pieces of fabric in the appropriate position while robotic sewing arms buzz around stitching the pieces together, much like the spot-welding machines found in car factories.

To what extent Leapfrog is a response to genuine market need, as opposed to a piece of industrial policy intended to keep the European garment-making industry alive in the face of competition from low-wage countries, is not yet clear. The European Commission has contributed €16m ($20m) to it, but private enterprise, in the form of firms such as Hugo Boss and La Redoute, has chipped in €9m as well. It could yet turn out to be a boondoggle. But perhaps the spirit of Hargreaves is, indeed, alive and well.

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Muslims in Russia

Mosque and state

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Reuters

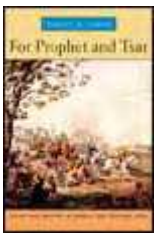
Tsarist Russia used Muslim notables to shore up the state. Despite the Chechen war, a similar entente is not inconceivable, even now

WHEN the ruler of a multinational empire bases his authority on one great religion, how many other religions can the empire—and indeed, the emperor—accommodate, and then turn into an instrument of power? The Ottoman sultans, when faced with this question, found a ready-made answer in Islamic theology. As "people of the book" with common roots in the holy texts of the Abrahamic tradition, Christians and Jews were to be treated with respect—though not on a par with followers of the predominant Muslim faith—so long as they remained loyal to the empire.

The Russian tsars, who derived a big part of their mystique and authority from being anointed Christian monarchs—indeed, the only Orthodox Christian emperors in the world after the fall of Byzantium—faced a similar dilemma: how to present themselves, and legitimise their realm, in the eyes of their Muslim subjects.

To the discomfiture of the Russian Orthodox clergy, the Tsarist regime's response was pragmatic; it had no qualms about demanding loyalty from Muslims in the name of Allah and his Prophet. In the 1860s, when Russian commanders swept through Central Asia, they skilfully played the Muslim card.

For Prophet and Tsar: Islam and Empire in Russia and Central Asia
By Robert D. Crews



Harvard University Press; 480 pages; $29.95 and £19.95

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The Russian authorities knew they had to compete for the loyalty of their Muslim subjects against rival powers which were part of *Dar al-Islam*, the area where Islam prevailed. In this task repression alone would not suffice. The Russian state felt it must co-operate actively with at least some Muslim leaders in support of commonly agreed goals, such as social peace and respect for family obligations.

The attractions of a concordat between Russian nationalists and Muslims are still a factor in the Kremlin's calculations, even in a Russia which this week was rejoicing over the assassination of a Muslim Chechen warlord, Shamil Basayev (see article). To this day there are some Muslim leaders in Russia, such as

Talgat Tajuddin, the mufti pictured above with President Vladimir Putin, who are ready to line up with conservative Russian nationalists against things they all dislike—such as American policy or gay rights.

In tsarist times, as a new book by an American historian, Robert Crews, demonstrates, the Russians were even more single-minded in wooing Muslim notables. Soon after capturing Tashkent, General Mikhail Chernyayev entered an elaborate compact with local religious scholars, guaranteeing to uphold their authority, and that of other Muslim institutions, such as mosques and charities. In return, the greybeards had to deliver the loyalty of local people.

The repeated clashes between the Russian and Ottoman empires are sometimes portrayed as a classic "civilisational" war which pitted Christianity against Islam—with the result that every territorial adjustment prompted mass migrations by Christians and Muslims left on the "wrong" side of a new border. But that is not the whole story of Russia's southward expansion, says Mr Crews. Imam Shamil, the legendary leader of Chechen resistance to the tsars, had local Muslim enemies as well as Russian ones; and some Muslims fought on the Russian side.

Creating a Muslim hierarchy

As Mr Crews argues in his original and insightful book, the compact between tsarist and Islamist authority was deep and elaborate. As in most forms of theocracy, the Russian regime not merely tolerated the clerical elite; it shored up the elite by helping it to fight heresy and uphold *sharia* law. Given that Sunni (unlike Shia) Islam lacks a formal clerical structure, the Russians sometimes had to coax one into existence by boosting the authority of their favourites. But enforcement of the law, as the book shows, could not always be left to Islamic judges. Representatives of the Russian state often found themselves adjudicating (in strictly Islamic terms) the grievances of their Muslim subjects.

Mr Crews's research, much of it conducted in the newly accessible archives of provincial Russian places such as Ufa and Kazan, is of huge relevance to the present day. Although modern Russia has a secular constitution, not a theocratic one, some elements of the old relationship between the state and Russian Orthodoxy are being rebuilt. But from the state's point of view, there is a dilemma: how far can the compact with Orthodoxy go without precluding a similar one with the Russian Federation's 15m or so Muslim subjects?

The idea of some entente between modern Russian nationalism and Russian Muslims is not as absurd as it seems. Among the ideologues of neo-nationalism in Russia, there have been several figures of Muslim-Tatar background who subscribe to the ideal of a Eurasian or "Slavic-Turkic" union—roughly coinciding with the Soviet Union—whose common enemy is global, or Anglo-Saxon, capitalism.

But in other moods, contemporary Russian nationalism is stridently anti-Muslim. At least some of the time, the Russian Orthodox hierarchy portrays the war in Chechnya as a crusade against resurgent Islam—and similar rhetoric can be heard from the Russian state. But is it in Russia's interest to call the Chechen war a "civilisational" one, when that could alienate so many Muslims who live deep in the Slavic heartland? Russians, including Russian Muslims, are already arguing on this very point, and will continue to do so.

For Prophet and Tsar: Islam and Empire in Russia and Central Asia
By Robert D. Crews
Harvard University Press; 480 pages; $29.95 and £19.95

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About sponsorship

The United Nations

Caught in the middle

Jul 13th 2006
From The Economist print edition

The struggle between sovereignty and internationalism, continued

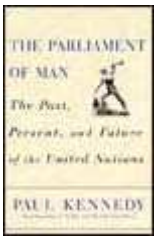
SOME 170 years ago, Alfred Tennyson, a future British poet laureate but then still in the flush of idealistic youth, wrote a rambling work called “Locksley Hall”, in which he looked forward to a time when the nations of the world would abandon the madness of war to form a political federation, the parliament of man:

> Till the war-drum throbb'd no longer, and the battle-flags were furl'd
> In the Parliament of man, the Federation of the world
> There the common sense of most shall hold a fretful realm in awe
> And the kindly earth shall slumber, lapt in universal law.

AP

One job done, dozens waiting

The Parliament of Man: The Past, Present, and Future of the United Nations
By Paul Kennedy



Random House; 361 pages; $26.95.
Penguin/Allen Lane; £25

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It is from this that Paul Kennedy, a British-born professor of history at Yale and the author or editor of 13 books, including “The Rise and Fall of the Great Powers” (claimed by his publishers to be the “best-selling history book of modern times”), borrowed the title for his first major work in a decade. This time he relates the story of the rise and fall—and possible rise again—of the United Nations, the nearest our world has ever got to Tennyson's parliament of man, yet still a very pale shadow of that dream.

Mr Kennedy relates how Harry Truman, one of the UN's chief architects and a great Tennyson fan, used to carry around those lines from “Locksley Hall” for years, whisking them out of his wallet to read to puzzled senators and officials whenever he was asked about his commitment to international organisation. At the UN's founding conference in San Francisco in 1945, Truman, the leader of the most powerful nation on earth, sought to make clear what this commitment involved: “We all have to recognise, no matter how great our strength, that we must deny ourselves the licence to do always as we please,” he said. His compatriots have been straining against that bit ever since.

This tension helps to explain the difference in the subtitles of the American and British editions of Mr Kennedy's book. Blandly neutral in the American edition, “The Past, Present, and Future of the United Nations”, in the British edition it reads, “The United Nations and the Quest for World Government”. The British text would be a red rag to American conservatives already incensed by perceived encroachments on American sovereignty by the world body. What may have been just about acceptable in 1945, when the UN was a relatively cosy club of 50 members, dominated by the rich democratic nations of the north, grew increasingly intolerable to many Americans as the club's ranks swelled to 192, dominated by the developing nations of the south.

The struggle between sovereignty and internationalism, epitomised by the impassioned relations between America and the UN, is the leitmotif of the book. It explains so many of the world body's disastrous failures. Yet it is never tackled directly. Mr Kennedy's approach is to examine various themes—peacekeeping, economic development, security and so on—leaning over backwards in his apportionment of criticism (loads of it) and praise (much less). Even so, America's role seems to jump out from almost every page.

It was at America's (and the Soviet Union's) insistence that the virtually immutable veto system was introduced for the five permanent members—America, Russia, Britain, France and China, the victors in the second world war—of the Security Council, the most important and powerful of the UN's many organs. The system was designed to keep the potentially isolationist Great Powers inside the UN tent. Yet, more than any other single factor, it has proved the biggest cause of the UN's multiple failures. Any one of the so-called P5 can paralyse the world body. Hence the failure to intervene, or the slowness in intervening, as countless conflicts and cruelties slip by: the long years of apartheid in South Africa; the Rwandan genocide; the Indian-Pakistani dispute over Kashmir; the unending fighting between Israel and the Palestinians; the dilly-dallying over Darfur's atrocities; the tip-toeing around North Korea and Iran and their actual or future acquisition of nuclear weapons.

The Great Powers of 1945 are no longer the great powers of today. Questions have to be asked why Britain, with its 60m inhabitants, should have a veto and not India with its more than one billion, or why Japan, the world's second biggest economy, does not have a veto, though France, with an economy less than half the size, does? Why doesn't a single Arab or Muslim country have a permanent seat? The system is manifestly unfair and a source of huge resentment in the third world. Yet this flawed, anachronistic set-up cannot be changed without the say-so of the very nations who would stand to lose most from any genuine reform. So it won't be.

Yet, argues Mr Kennedy, this is not necessarily all bad. Indeed, he sees the veto system as a kind of pressure valve. Far better to allow the United States to be obstructionist than to have it walk out, he says. For much the same reason, he suggests that the decision to go it alone over the Iraqi war, without explicit UN approval, should not be seen as a failure of the UN system, but rather that it had worked by allowing the United States, although much criticised, to do what it wanted to do without having to leave the organisation.

Half a century after writing “Locksley Hall”, Tennyson recanted. Colonialism, wars in Crimea, Italy and Germany, revolt in Ireland and the erosion of religious belief had shattered his earlier optimism. Now all was chaos, menace madness. “Who can tell how all will end?” he cries in “Locksley Hall Sixty Years After”, written in 1886. One answer was the two world wars. The UN was set up to prevent such wars ever happening again.

Its ambitions and ideals were high—too high for “this wicked world”, Gladwyn Jebb, a British diplomat and the UN's first acting secretary-general, feared. In many ways, he has been proved right. As Mr Kennedy points out, parts of the UN have performed wonderfully, but others have failed miserably. To dismiss the world body out of hand, as some (read, American) critics do, is not just unfair, he argues, but also absurd. “Without the actions and existence of the world organisation, humankind would be a lot worse off than it is today, warts and all,” he concludes. But this much has been said before, and will no doubt be said again. Though undeniably true, it is faint praise.

The Parliament of Man: The Past, Present, and Future of the United Nations
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Iraq documentaries

Remembering how it may have been

Jul 13th 2006
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A brief flowering of cinéma vérité from the most dangerous of film locations

A YOUNG mechanic's apprentice, aged 11, murmurs dreamily "*Kanit helwa*" (it was beautiful) as the first images of "Iraq in Fragments" glide by. An unarmed Baghdadi police officer guides traffic; a bright-red double-decker bus passes slowly by, its windows bending the reflections of a street full of Iraqi faces. "The bridges...the water", the child's Arabic continues, as a bright goldfish floats across the surface, an aquarium captured through a shop window. The scene was shot a few months before the war began, and the youthful narrator, reminiscing two years later, may well have idealised his homeland's recent past. The film shows what happened to this hopeful and bedraggled boy in the years that followed.

"Iraq in Fragments", directed by James Longley, an American documentary film-maker, is undeniably beautiful. It is also harrowing. Earlier this year it took the Sundance film festival by storm, winning three top prizes, and by August it will have been shown at dozens more festivals. It is one of several remarkable feature-length documentaries to have sprung forth from the efforts of intrepid film-makers who shot digital video, with great patience and bravery, in those fleeting months during which it was possible to follow ordinary Iraqis through their own country.

Mr Longley stresses the important difference between documentaries that are made by a film-maker on location, shooting his own footage and working out his subject as he shoots, and documentaries that are assembled through archival research. Thanks to the proliferation of affordable digital-video technology, the Iraqi war has generated an unprecedented amount of daily news footage. Documentaries will be assembled from this material for many years to come. But this summer, for the first time since the American-led invasion three years ago, a series of innovative documentaries of the other type take up the lives of Iraqis in *cinéma vérité* style.

Last year two American-produced films, "Gunner Palace" and the excellent "Occupation Dreamland", treated the bewildering experience of American soldiers stumbling into the difficulties of the war's first year. They were shot by small "embedded" crews and excelled in conveying the confusion and anxiety felt by their American subjects. This summer's crop was slower to appear for the simple reason that the subjects are further from the reach of Western film-makers.

Tragic and compelling

The aim here is to shed light on Iraqis' experience of life after the fall of Saddam Hussein. Mr Longley

travelled around the country for two and a half years to make his film; Laura Poitras spent nine dangerous months in Baghdad shooting “My Country, My Country”, the story of a heroic middle-class doctor who runs a quixotic campaign for public office. Andrew Berends risked six months in the south of Iraq to film “The Blood of My Brother”, about a family's response to the violent death of a young breadwinner.

Each of these films is influenced by the *vérité* style to the extent that the film-makers seek to disappear from the stories they tell. They offer no guidance to the viewer in the form of scripted narration. In the case of Ms Poitras's stirring film, there is no voice-over whatsoever. The directors filmed alone or with a translator, operating their own cameras. They spent countless hours with the men, women and children they depict, building such a level of comfort between subjects and camera that the filmgoer may enter a family's living room as casually as a trusted friend.

Mr Longley shot 300 hours of footage to make his 92-minute film; Ms Poitras spent days and nights with her subject's family. Her camera is rolling when the news arrives that insurgents have kidnapped a cousin; the effect is blood-curdling, more so than any television footage of bombs bursting over Falluja. In “The Blood of My Brother”, the point of view in one scene is just behind a Bradley's gunner; in another it runs alongside fighters from the Mahdi army as they draw American fire. The best of these films tend to be without apparent politics. But they all view Iraq's story as a tragedy unfolding.

Foreign journalists with video cameras are still working in central Iraq, but now circumstances are such that when they leave their fortified compounds, they must travel in pairs of cars, accompanied by armed guards. This expensive security is beyond the budget of the *vérité* film-maker, who could not anyway achieve the sort of intimacy needed in the company of a hired gun. One of Mr Longley's Iraqi translators was shot to death in January, while on the job with an American reporter. Iraqis themselves have begun to make documentaries but not yet of great quality. So this season's films may not only be the first but also the last of their particular kind to appear for some time.

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Australian history

A secular saint, for some

Jul 13th 2006
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IT WOULD have been a very different story if the American colonists had not declared independence. By doing so, they ended the transportation of convicts and misfits from Britain to the new world: perhaps 120,000 had been sent between 1650 and 1775. Instead, the Home Office decided that the convicts confined in the squalid hulks moored in ports and rivers should be sent to a netherworld. They were shipped off to New South Wales, a place known only from accounts, often erroneous, of Captain Cook's voyages.

Tom Keneally deploys his skills as a novelist to give depth to his work as an historian. His unlikely hero is Arthur Phillip, the first governor of New South Wales, a conscientious, decent man who was born in Bread Street in the shadow of St Paul's Cathedral, where his bust now stands. Mr Keneally does not dissent from the conclusion of earlier historians of Australia, such as Manning Clark and Robert Hughes, who regard Governor Phillip as pretty dull. His language lacked the dashing political romanticism of a Thomas Jefferson, but he did mean what he said. Before the First Fleet left Portsmouth in 1787, Phillip wrote: “There can be no slavery in a free land, and consequently no slaves.” At the time, Jefferson was sleeping with one of his.

There was plenty of sex in NSW. The remarkable fecundity of convict women was attributed to a sweet tea herb, *Smilax glyciphylla*. Relationships were established with soldiers and staff as well as with other convicts, but Phillip insisted that these marriages of convenience should be binding. “He was making the first families of non-aboriginal Australia,” notes Mr Keneally, who also identifies in Phillip a genuine streak of collectivism, of the European variety.

When food stocks ran low in the harsh conditions of the early years of the settlement, Phillip insisted that what they had should be shared equally, among convicts as well as soldiers. “Authority and equality were the two trees he planted in Sydney Cove,” writes Mr Keneally, who sees Phillip as “a colourless, secular saint [whose] spirit, pragmatic and thorough, is still visible in Australia.”

Mr Phillip's problem, and the aboriginals' tragedy, was his inability to understand the people who had arrived tens of thousands of years earlier. Yet it was not for want of trying: the governor sought to have good relations with the aboriginals.

In Mr Keneally's story, Phillip's relationship with a tribal leader named Bennelong is sensitive and sad, even though Bennelong had been one of a party of aboriginals who attacked and wounded him. Bennelong became an adviser to the governor and was sufficiently trusted to accompany him when he returned to England in 1792. Phillips gave him a house on a point in Sydney Cove—a couple of hundred years later Bennelong Point became the site of the Sydney Opera House.

But Bennelong was incapable of explaining to Phillip, an English liberal who took pride in having granted 3,470 acres of land to former convicts, that the land and the sea were the property of all aboriginal tribes. This was native Australia's form of collectivism—not Europe's.

The Commonwealth of Thieves: The Story of the Founding of Australia
By Thomas Keneally
Chatto & Windus; 509 pages; £20.
To be published in America by Nan A. Talese in October

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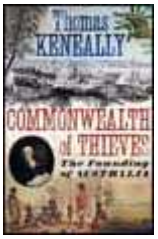
By Thomas Keneally



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African writing

Tales of cruelty

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The winner of an African prize

MARY WATSON, a 31-year-old South African writer who has made a speciality of exploring a single event from myriad viewpoints, has this week beaten more than 100 entrants from 21 African countries to win this year's £10,000 ($18,500) Caine prize for African writing.

“Jungfrau”, her searing tale of a child fighting to be good in the face of her father's infidelity and her mother's everyday struggle against apartheid is one of a collection of interlinked stories, “Moss”, published by Kwela in 2004. The stories all explore themes of innocence and cruelty, loss and belonging, through the distorted prism of Cape Town in the apartheid period. Ms Watson, a protégé of André Brink, whose 1978 novel “Rumours of Rain” explored many of the same tensions for an older generation, is currently working on her first novel and also on a collaborative novel with a group of other South African writers.

The Caine prize, whose patrons are the four African winners of the Nobel prize for literature, was founded in 2000 and named after the late Sir Michael Caine, once chairman of Booker plc. It has launched the careers of several African writers including Helon Habila from Senegal, and a Kenyan writer, Binyavanga Wainaina.

Last year's winner, S.A. Afolabi, from Nigeria, has just had his first collection of short stories, “A Life Elsewhere”, published in Britain by Jonathan Cape. His first novel is due out next spring.

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About sponsorship

Shamil Basayev

Jul 13th 2006
From The Economist print edition

Shamil Salmanovich Basayev, a Chechen warlord, died on July 10th, aged 41

AP

WHEN Shamil Basayev was told that he was Russia's most wanted man, he laughed. All right, he admitted, he was a “bad guy, a bandit, a terrorist”. But he was hunting terrorists himself, he argued: the “pigs” and “infidels” who occupied Chechnya, his Caucasian province. His own name for Russia was “Rusnya”, delivered with a sneer. His philosophy was succinct: “I want to spit on the whole world if the whole world spits on me.”

He had been a wanted man since he took more than 1,200 hostages, of whom more than 100 died, in the Russian city of Budyonnovsk in 1995. He was wanted for his involvement in another mass hostage-taking, at a Moscow theatre in 2002, and a string of bombings and assassinations. But the zenith of his terrorist career came in the summer of 2004. Mr Basayev and his cohorts overran Nazran, the main city of Ingushetia, next to Chechnya; his suicide-bombers blew up two planes and a Metro station. Then, by his own account, he orchestrated the seizure of a school in Beslan. More than 300 people died, half of them children. Beslan shocked him, he admitted, but only briefly. It was the Russians' fault, he said, for not agreeing to his conditions. Perhaps he quelled his doubts with the memory of his own wife and children, killed in a Russian air raid in 1995, and of Stalin's wholesale deportation of the Chechens in 1944 to Kazakhstan, when as many as 100,000 perished.

By the end, Mr Basayev had alienated most of the Chechens who once revered him, ruptured the separatist movement and disgraced its cause abroad—a cause that by then had anyway morphed into the pursuit of an Islamist state across the north Caucasus. Both it, and Mr Basayev, had become mixed up with the severe Wahhabist doctrines which, after the collapse of communism, seeped into the Caucasus from the Middle East. And yet he had not always been a fanatic, or a monster. His first name, Shamil, was that of a 19th-century imam who had waged unremitting war against the tsarist armies round Vedeno, Mr Basayev's home village. As a young man, though, he seemed keener on Che Guevara than

on Muhammad.

Nor did he always hate Russia. He served as a fireman in the Soviet army and wanted to study law, but wound up lackadaisically selling computers in Moscow. Then the Soviet Union collapsed, and he returned to the Caucasus to fight. He battled for the freedom of Abkhazia in a Russian-backed coalition against the Georgians. He fought with distinction in Russia's first Chechen war, launched by Boris Yeltsin in 1994; the bandit raid he led into Dagestan in 1999 helped to ignite the second. In between them, during Chechnya's short spell of de facto independence, he was briefly its prime minister. He was too powerful a figure to be ignored; but by then he was a man only of violence, and peaceful politics bored him.

Russia's useful demon

Soon before his death he was appointed vice-president of Ichkeria, the diehard rebels' name for their non-existent state. To be a Chechen leader—either of the separatists, or of the assorted regimes installed by the Kremlin in sham elections since the worst fighting ended—is a dangerous occupation. Almost all, on both sides, have died bloodily. In a region where money and greed are at least as powerful as religion or politics, almost all have done so in murky circumstances. So too did Mr Basayev. The Kremlin said he was killed in a special operation. His own people, and some local officials, insist he died in an accidental explosion.

Likewise, it is not clear which had finally run out: Mr Basayev's luck, or his usefulness. Many in the Caucasus and beyond wonder why, if Mr Basayev really was so wanted by the Russians, he remained alive for so long, in such a small and militarised area. His residual mystique came partly from his ability to move around Chechnya and the surrounding regions with spooky ease. His men boasted of buying their weapons from federal troops. And in the dialectical logic of the former Soviet Union, his barbarity may have been helpful.

Many Chechens believe Mr Basayev was left alive, while other, comparatively moderate insurgents were not, so that the separatist cause should have only one demonic face. With his shaven head, thick beard and prosthetic leg, fitted after he lost a foot to a landmine—the features by which what remained of his body were identified—he became, for most Russians, the monstrous incarnation of the Chechen resistance.

The results of his death are ambiguous. No other rebel leader possessed such daring and infamy; but some are now talking about pressing the fight farther north into Russia. Chechnya's own future now rests on two men, with whom Mr Basayev's fate had become intertwined. One of them is Ramzan Kadyrov, the young, erratic rebel turned prime minister of Chechnya, whose father, once its president, Mr Basayev claimed to have assassinated. The other man is Vladimir Putin, who was eased into Russia's presidency in 2000 by the war that followed Mr Basayev's Dagestan raid. Mr Putin vowed to catch him, and he has done so, just before the summit he is hosting in St Petersburg. He will doubtless be congratulated on the timely demise of Russia's most-wanted man.

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Overview

Jul 13th 2006
From The Economist print edition

America's businesses, excluding farms, added 121,000 workers to their payrolls in June. The unemployment rate remained unchanged at 4.6%. America's trade deficit in goods and services reached $63.8 billion in May, thanks in part to higher oil prices. Its biggest bilateral deficit, with China, expanded to $17.71 billion from $17.03 billion in April.

Industrial production in **Germany** and **France** made big gains in May. Increases in manufacturing and construction raised German industrial output by 1.5% from the previous month and 6% from a year earlier. In France production rose by 2%, the biggest gain in six months, leaving it 2.7% higher than in May 2005.

In **Japan** core orders for machinery, which exclude those from ship builders and electricity companies, fell by less than expected in May. The 2.1% drop from the previous month was less than forecasts of over 5%, suggesting that investment spending may be stronger than expected. Meanwhile, producer prices in Japan rose by 3.3% in the year to June.

Average earnings in **Britain** increased faster than expected in the three months from March to May, at an annual pace of 4.1%. Pay was boosted by bonuses in financial services and the public sector. Unemployment hit a 5½-year high of 5.4%, largely because of a growing labour pool.

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Output, demand and jobs

Jul 13th 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.1	Q1	+ 3.5	+ 3.2	+ 3.4	– 1.0	Q1	+ 2.7	Q1	4.9	Jun	5.0
Austria	+ 3.0	Q1	+ 2.4	+ 2.2	+ 1.9	+ 8.4	Apr	+ 1.1	Apr	4.8	Jun	5.2
Belgium	+ 2.2	Q1	+ 3.2	+ 2.4	+ 1.9	+ 7.6	May	+ 0.8	Apr	12.0	May†	12.2
Britain	+ 2.3	Q1	+ 2.3	+ 2.4	+ 2.5	– 0.7	May	+ 4.0	May	5.4	May‡	4.7
Canada	+ 3.2	Q1	+ 3.8	+ 3.2	+ 2.7	+ 3.1	Apr	+ 5.7	Apr	6.1	Jun	6.8
Denmark	+ 3.5	Q1	+ 0.8	+ 2.7	+ 2.2	+ 6.1	May	+ 5.3	May	4.5	May	5.9
France	+ 1.5	Q1	+ 2.2	+ 2.1	+ 1.9	+ 2.7	May	+ 1.4	May	9.1	May	10.1
Germany	+ 1.4	Q1	+ 1.6	+ 1.8	+ 1.2	+ 6.0	May	+ 3.2	May	10.9	Jun§	11.9
Italy	+ 1.5	Q1	+ 2.4	+ 1.3	+ 1.1	+ 2.9	May	+ 1.5	Apr	7.7	Dec	7.9
Japan	+ 3.8	Q1	+ 3.1	+ 3.0	+ 2.4	+ 3.9	May	– 0.3	May	4.0	May	4.4
Netherlands	+ 2.9	Q1	+ 0.7	+ 2.3	+ 2.1	+ 1.8	May	+ 8.0	Apr	5.8	May††	6.7
Spain	+ 3.5	Q1	+ 3.3	+ 3.3	+ 2.8	+ 7.9	May	+ 1.3	May	8.3	May	9.3
Sweden	+ 4.1	Q1	+ 4.6	+ 3.7	+ 2.8	+ 6.3	May	+11.8	May	4.8	May†	5.2
Switzerland	+ 3.5	Q1	+ 3.8	+ 2.9	+ 1.9	+ 9.2	Q1	– 0.7	Apr	3.1	Jun†	3.6
United States	+ 3.7	Q1	+ 5.6	+ 3.4	+ 2.7	+ 4.3	May	+ 4.7	May	4.6	Jun	5.0
Euro area	+ 1.9	Q1	+ 2.4	+ 2.2	+ 1.8	+ 1.9	Apr	+ 0.8	May	7.9	May	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.8	Q1	+ 1.6	na	na	+15.4	May	+ 6.8	Apr	7.6	May	8.3
Greece	+ 4.1	Q1	na	na	na	+ 0.6	May	+ 9.8	Apr	9.7	Q1	10.4
Iceland	+ 5.0	Q1	na	na	na	na		na		1.3	May†	2.2
Ireland	+ 5.7	Q4	+ 7.6	na	na	+ 6.9	May	+ 6.7	Apr	4.5	Jun	4.3
Luxembourg	+ 5.7	Q4	na	na	na	+12.5	Apr	+ 4.6	May	4.1	May	4.0
New Zealand	+ 2.1	Q1	+ 2.3	na	na	– 2.9	Q4	+ 3.0	Q1	3.9	Q1	3.9
Norway	+ 5.4	Q1	+ 2.3	na	na	– 5.2	May	+ 6.3	May	3.7	May††	4.7
Portugal	+ 1.0	Q1	+ 1.8	na	na	+ 6.8	May	+ 2.4	May	7.7	Q1†	7.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Mar-May; claimant count rate 3.0% in Jun. §EU harmonised rate 8.3% in May. ††Mar-May.

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About sponsorship

Prices and wages

Jul 13th 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 3.0	Q1	+ 2.4	+ 2.9	+ 2.7	+ 7.9	Q1	+ 6.0	+ 4.0	Q1	+ 4.5
Austria	+ 1.7	May	+ 2.3	+ 2.0	+ 1.9	+ 3.9	Jun	+ 0.7	+ 2.8	May	+ 2.3
Belgium	+ 1.9	Jun	+ 2.9	+ 2.1	+ 1.9	+ 5.6	May	+ 2.4	+ 2.3	Apr	+ 2.6
Britain	+ 2.2	May*	+ 1.9	+ 2.0	+ 1.9	+ 3.3	Jun	+ 2.5	+ 4.1	May†	+ 4.1
Canada	+ 2.8	May	+ 1.6	+ 2.3	+ 2.1	+ 2.5	May	– 0.3	+ 0.2	Apr	+ 2.6
Denmark	+ 2.2	Jun	+ 1.8	+ 2.0	+ 2.0	+ 5.7	May	+ 3.0	+ 2.9	Q1	+ 3.1
France	+ 1.9	Jun	+ 1.7	+ 1.9	+ 1.6	+ 4.1	May	+ 2.5	+ 3.3	Q1	+ 2.9
Germany	+ 2.0	Jun	+ 1.8	+ 1.8	+ 2.3	+ 5.3	Jun	+ 2.2	+ 2.2	Apr	+ 1.5
Italy	+ 2.3	Jun	+ 1.8	+ 2.1	+ 1.9	+ 6.6	May	+ 3.2	+ 2.6	May	+ 3.1
Japan	+ 0.6	May	+ 0.2	+ 0.5	+ 0.6	+ 3.3	Jun	+ 1.4	+ 0.6	May	+ 0.1
Netherlands	+ 1.3	Jun	+ 1.6	+ 1.5	+ 1.5	+ 6.0	May	+ 3.8	+ 1.9	Jun	+ 0.6
Spain	+ 4.0	Jun	+ 3.2	+ 3.6	+ 2.9	+ 6.5	May	+ 4.2	+ 3.0	Q1	+ 2.5
Sweden	+ 1.5	Jun	+ 0.6	+ 1.4	+ 1.8	+ 5.0	May	+ 2.4	+ 3.6	Apr	+ 2.3
Switzerland	+ 1.6	Jun	+ 0.7	+ 1.3	+ 1.2	+ 2.4	May	+ 0.3	+ 1.0	2005	+ 0.9
United States	+ 4.2	May	+ 2.8	+ 3.5	+ 2.4	+ 4.5	May	+ 3.6	+ 3.9	Jun	+ 2.7
Euro area	+ 2.5	Jun	+ 2.1	+ 2.2	+ 2.1	+ 6.0	May	+ 3.5	+ 2.2	Q1	+ 3.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.7	May	+ 0.8	na	na	+ 6.7	May	+ 2.3	+ 3.4	Q1	+ 4.0
Greece	+ 3.2	Jun	+ 3.3	na	na	+ 8.4	May	+ 3.0	na		na
Iceland	+ 8.4	Jul	+ 3.5	na	na	+ 7.1	Jun	+ 4.2	+ 8.7	May	+ 6.6
Ireland	+ 3.9	May	+ 2.4	na	na	+ 0.6	May	– 2.2	+ 2.2	Q1	+ 6.4
Luxembourg	+ 3.1	May	+ 2.4	na	na	+ 5.4	Apr	+10.1	+ 2.2	Apr	+ 1.0
New Zealand	+ 3.3	Q1	+ 2.8	na	na	+ 7.2	Q1	+ 4.2	+ 3.3	Q1	+ 2.5
Norway	+ 2.1	Jun	+ 1.7	na	na	+13.2	Jun	+19.3	+ 3.6	Q1	+ 4.2
Portugal	+ 3.0	May	+ 1.8	na	na	+ 5.8	May	+ 3.7	+ 1.5	May	– 3.3

*RPI inflation rate 3.0% in May. †Mar-May.

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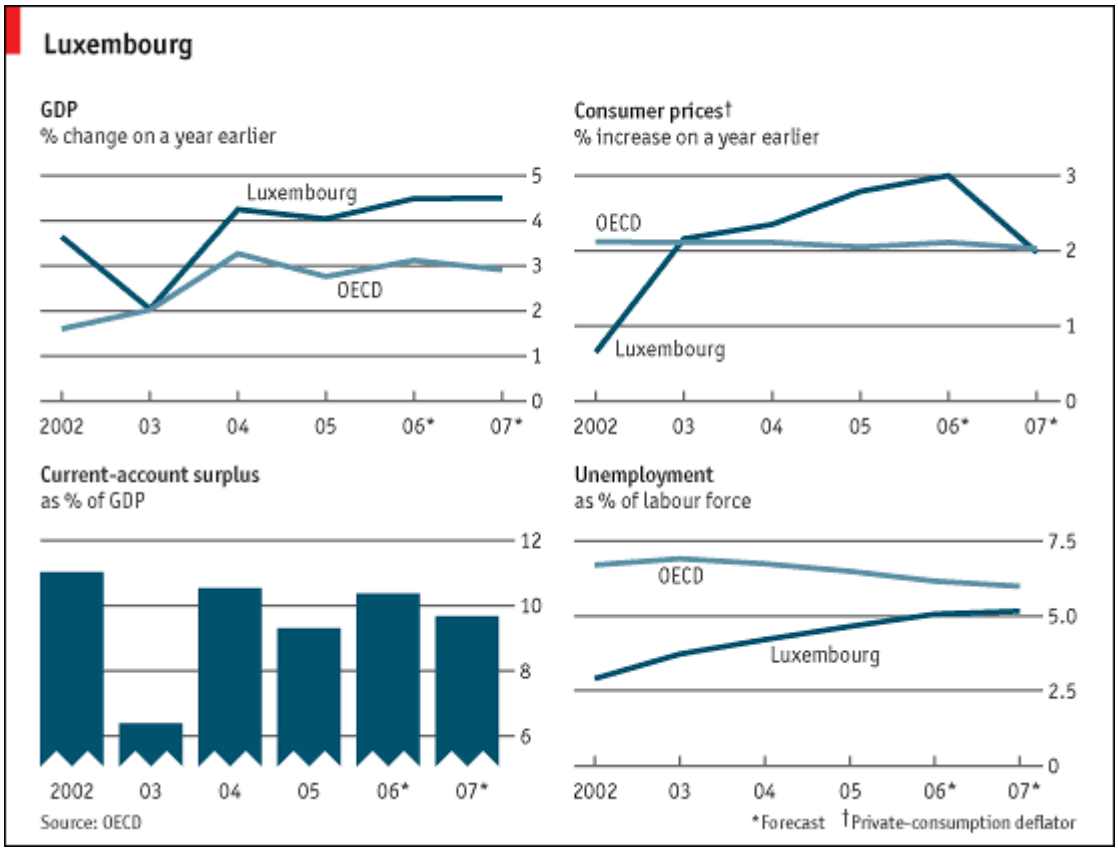
About sponsorship

Luxembourg

Jul 13th 2006
From The Economist print edition



For a landlocked country, Luxembourg is an export powerhouse. Its current-account surplus will exceed 10% of GDP this year and net exports have made a big contribution to its recent growth. Financial services, which account for almost one-third of Luxembourg's economy, have done well, thanks to the recovery of the world's stockmarkets since 2003. But by its own past standards, Luxembourg is ailing, according to the OECD's latest survey of the country. Productivity has slowed, the country's public finances have deteriorated and inflation, though around only 3%, has outstripped that of its trading partners. The OECD notes that Luxembourg's employers often prefer to recruit cross-border commuters, who settle for lower wages, meaning that the income earned by Luxembourg's nationals has grown more slowly than the income generated within its borders.

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Money and interest rates

Jul 13th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jul 12th 2006)					
				3-mth money market		2-year gov't bonds	10-year gov't bonds		corporate bonds
	narrow	broad		latest	year ago		latest	year ago	
Australia	+ 9.0	+ 9.8	May	6.00	5.65	5.86	5.81	5.24	6.86
Britain	+ 5.4‡	+11.8	May	4.67	4.63	4.73	4.66	4.31	5.09‡
Canada	+11.9	+ 6.5	May	4.20	2.52	4.23	4.49	4.00	5.81
Denmark	+13.8	+13.2	May	3.19	2.20	3.70	4.08	3.19	5.30
Japan	+ 4.0	+ 1.2	Jun	0.29	0.02	0.84	1.93	1.25	2.12
Sweden	+ 0.6	+11.5	May	2.27	1.48	3.23	4.00	3.06	3.98
Switzerland	+ 1.4	+ 3.3	May	1.52	0.75	1.99	2.84	1.98	2.77
United States	+ 1.7	+ 4.7	May§	5.38	3.42	5.16	5.09	4.16	6.03
Euro area†	+10.2	+ 8.9	May	3.08	2.12	3.60	4.04	3.22	4.66

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series. §New series for broad money supply. Benchmarks: US 30-year 5.14%, Japan No. 281 1.93%. Central bank rates: US fed funds 5.25%, ECB refinancing 2.75%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jul 13th 2006
From The Economist print edition

2000=100

	Jul 4th	Jul 11th*	% change on one month	% change on one year
Dollar index				
All items	175.8	180.9	+ 8.0	+ 33.5
Food	139.7	141.8	+ 5.4	+ 9.3
Industrials				
All	222.4	231.5	+10.2	+ 62.0
Nfa†	161.5	160.2	– 3.5	+ 17.4
Metals	255.6	270.3	+15.4	+ 84.7
Sterling index				
All items	144.3	148.8	+ 7.6	+ 28.5
Euro index				
All items	127.0	131.2	+ 6.4	+ 27.8
Yen index				
All items	186.9	191.8	+ 7.1	+ 37.6
Gold				
$ per oz	624.75	634.55	+10.1	+ 48.7
West Texas Intermediate				
$ per barrel	72.86	74.03	+ 5.4	+ 22.3

*Provisional. †Non-food agriculturals.

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Stockmarkets

Jul 13th 2006
From The Economist print edition

Market indices

	Jul 12th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,093.4	5,318.2	4,708.8	+ 0.8	- 4.2	+ 8.2	+10.9
Austria (ATX)	3,783.5	4,344.4	3,324.1	+ 0.3	- 12.9	+ 3.2	+11.0
Belgium (Bel 20)	3,718.1	3,987.3	3,445.1	+ 0.9	- 6.8	+ 4.8	+12.7
Britain (FTSE 100)	5,860.6	6,132.7	5,506.8	+ 0.6	- 15.4	+ 4.3	+11.3
Canada (Toronto Composite)	11,771.1	12,487.3	10,904.3	+ 1.2	- 5.7	+ 4.4	+ 7.1
Denmark (OMXCB)	349.8	395.5	325.0	+ 0.2	- 11.6	- 4.9	+ 2.3
France (SBF 250)	3,478.6	3,755.6	3,244.2	+ 0.4	- 20.8	+ 5.4	+13.4
France (CAC 40)	4,941.7	5,312.2	4,615.4	+ 0.4	- 28.6	+ 4.8	+12.7
Germany (DAX)*	5,637.8	6,140.7	5,292.1	+ 0.2	- 30.1	+ 4.2	+12.1
Italy (S&P/MIB)	36,298.0	38,765.0	34,850.0	+ 0.3	- 27.6	+ 1.7	+ 9.4
Japan (Nikkei 225)	15,249.3	17,563.4	14,218.6	- 1.8	- 60.8	- 5.4	- 3.4
Japan (Topix)	1,563.7	1,783.7	1,458.3	- 1.7	- 45.8	- 5.2	- 3.2
Netherlands (AEX)	440.4	478.0	412.9	+ 0.3	- 37.2	+ 0.8	+ 8.5
Spain (Madrid SE)	1,252.9	1,318.5	1,156.8	+ 0.3	- 5.0	+ 8.4	+16.6
Sweden (Affarsvarlden Gen)	295.0	333.7	275.2	- 1.2	- 26.3	+ 0.5	+10.6
Switzerland (Swiss Market)	7,707.0	8,122.1	7,154.9	+ 0.6	- 8.4	+ 1.6	+ 8.3
United States (DJIA)	11,013.2	11,642.7	10,667.4	- 1.2	- 6.1	+ 2.8	+ 2.8
United States (S&P 500)	1,258.6	1,325.8	1,223.7	- 1.0	- 17.6	+ 0.8	+ 0.8
United States (NASDAQ Comp)	2,090.2	2,370.9	2,072.5	- 2.9	- 58.6	- 5.2	- 5.2
Europe (FTSEurofirst 300)†	1,312.4	1,405.6	1,238.7	+ 0.5	- 23.0	+ 2.9	+10.7
Euro area (FTSE Euro 100)†	1,115.3	1,198.7	1,050.0	+ 0.3	- 28.1	+ 2.4	+10.2
World (MSCI)‡	1,305.8	1,406.3	1,243.9	- 0.6	- 9.9	+ 3.8	+ 3.8
World bond market (Citigroup)††	633.2	648.4	612.1	+ 0.3	- 5.0	+ 2.1	+ 2.1

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jul 13th 2006
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	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Jul 12th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Jul 12th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2006‡
Australia	− 11.7	Apr	− 40.6	Q1	− 5.6	− 5.2	117.5	116.8	1.33	1.34	2.44	1.69	1.15	+ 0.9
Austria	− 1.2	Apr	+ 0.5	Dec	+ 0.3	− 0.1	105.3§	105.7	0.79	0.83	1.44	–	0.68	− 1.9
Belgium	+ 13.2	Apr	+ 7.3	Mar	+ 1.5	+ 1.6	107.1§	107.6	0.79	0.83	1.44	–	0.68	− 0.4
Britain	−128.1	May	− 52.3	Q1	− 2.9	− 2.9	99.3	98.0	0.55	0.57	–	0.69	0.47	− 3.4
Canada	+ 59.9	May	+ 31.8	Q1	+ 2.1	+ 1.1	126.7	119.9	1.14	1.21	2.09	1.45	0.99	+ 2.2
Denmark	+ 8.5	May	+ 5.1	May	+ 2.3	+ 2.2	106.4	105.9	5.88	6.17	10.8	7.46	5.09	+ 3.3
France	− 31.7	May	− 32.6	Apr	− 1.8	− 1.5	107.9§	108.5	0.79	0.83	1.44	–	0.68	− 2.9
Germany	+189.9	May	+108.1	May	+ 3.7	+ 3.8	109.4§	110.1	0.79	0.83	1.44	–	0.68	− 3.1
Italy	− 18.2	Apr	− 28.5	Apr	− 1.6	− 1.5	107.5§	108.0	0.79	0.83	1.44	–	0.68	− 4.2
Japan	+ 80.6	May	+165.8	May	+ 3.8	+ 3.8	81.4	85.7	116	112	212	147	–	− 5.2
Netherlands	+ 39.0	Apr	+ 42.3	Q1	+ 5.9	+ 5.8	108.0§	108.4	0.79	0.83	1.44	–	0.68	− 0.5
Spain	− 99.9	Apr	− 88.9	Mar	− 7.7	− 7.7	105.6§	105.9	0.79	0.83	1.44	–	0.68	+ 1.1
Sweden	+ 20.1	May	+ 23.2	Q1	+ 6.6	+ 6.1	98.9	95.7	7.23	7.76	13.3	9.18	6.26	+ 1.7
Switzerland	+ 7.8	May	+ 51.7	Q1	+13.4	+12.5	106.3	106.0	1.24	1.29	2.26	1.57	1.07	− 0.2
United States	−822.8	May	−808.5	Q1	− 6.8	− 6.9	84.0	86.2	–	–	1.83	1.27	0.87	− 3.6
Euro area	+ 2.2	Apr	− 39.2	Apr	− 0.4	− 0.3	119.0	116.1	0.79	0.83	1.44	–	0.68	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 7.1	May	+ 5.4	Apr	na	na	108.7§	109.2	0.79	0.83	1.44	–	0.68	+ 2.2
Greece	− 36.8	Apr	− 21.7	Apr	na	na	104.7§	104.9	0.79	0.83	1.44	–	0.68	− 3.0
Iceland	− 1.8	May	− 3.1	Q1	na	na	101.8**	101.3	74.2	65.1	136	94.2	64.2	+ 2.0
Ireland	+ 37.4	Apr	− 5.6	Q1	na	na	113.1§	114.0	0.79	0.83	1.44	–	0.68	− 0.3
Luxembourg	− 5.1	Apr	+ 3.6	Q4	na	na	107.1§	107.6	0.79	0.83	1.44	–	0.68	− 1.7
New Zealand	− 4.8	May	− 10.1	Q1	na	na	120.7	132.8	1.63	1.49	2.99	2.07	1.41	+ 4.6
Norway	+ 55.1	May	+ 50.2	Q1	na	na	110.6	110.8	6.27	6.53	11.5	7.96	5.42	+ 18.5
Portugal	− 22.8	Mar	− 16.9	Apr	na	na	105.1**	106.1	0.79	0.83	1.44	–	0.68	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD forecast. **IMF, February average.

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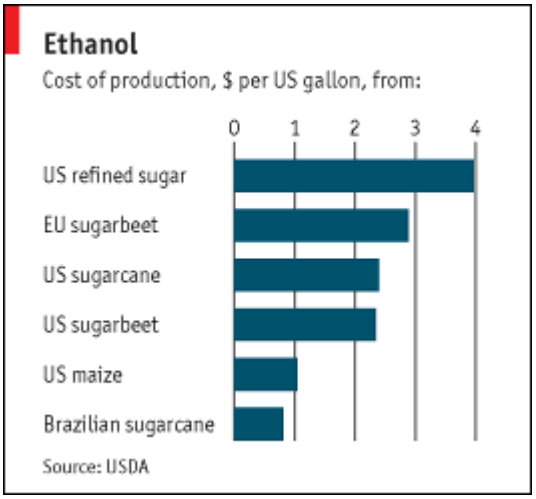
Ethanol

Jul 13th 2006
From The Economist print edition

In America it is cheaper to make fuel ethanol from maize because of the high domestic price of sugar. The Agriculture Department forecasts that America will use 34% more maize in ethanol production next season, some 20% of the harvest. Prices, up by a fifth this year, look set to rise further.



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Overview

Jul 13th 2006
From The Economist print edition

China chalked up a record trade surplus of $14.5 billion in June, compared with $13 billion in May. In the past 12 months it has accumulated a surplus of $123 billion. **Russia's** surplus for the year to May was even bigger, reaching $136 billion.

Brazil's consumer prices dropped by 0.2% in June, the biggest fall since 1998, because of cheaper ethanol and food. Consumer prices were still 4% higher than a year before.

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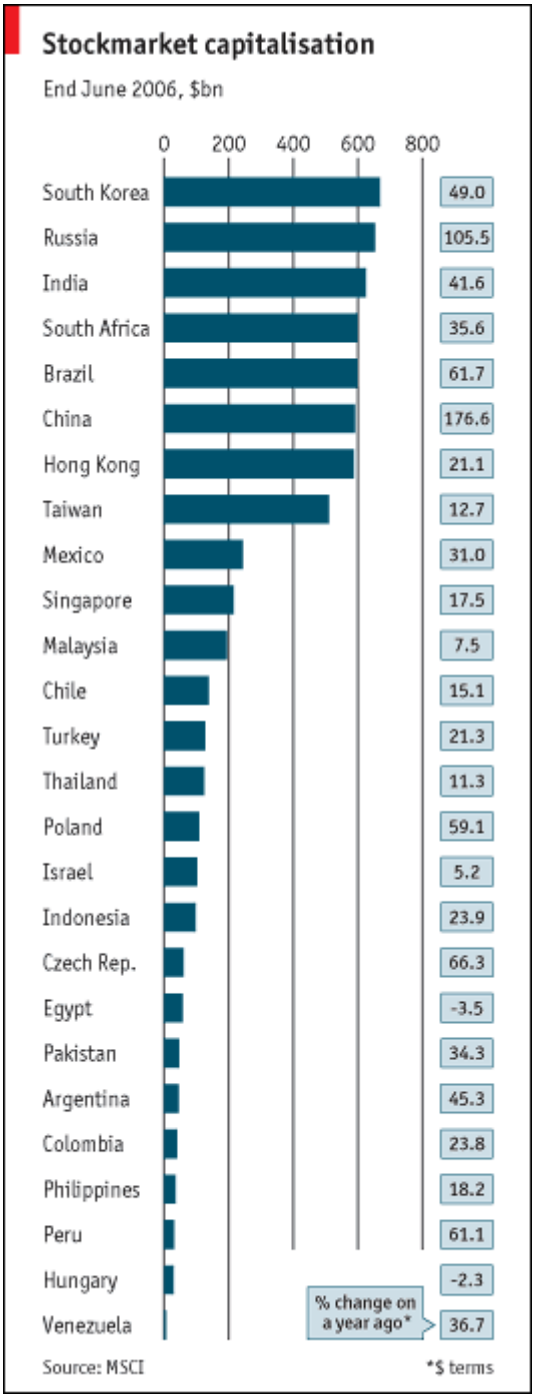
Stockmarket capitalisation

Jul 13th 2006
From The Economist print edition

South Korea now has the most valuable stockmarket among emerging economies, according to Morgan Stanley Capital International, displacing Hong Kong from last year's top spot. Despite a troubled two months, almost all of the emerging stockmarkets were bigger at the end of June 2006 than they had been a year earlier. In only Egypt and Hungary did market capitalisation fall.



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Economy

Jul 13th 2006
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+10.3	Q1	+17.9	May	+ 1.4	May	+123.0	Jun	+160.8	2005	925.0	May
Hong Kong	+ 8.2	Q1	+ 7.0	Q1	+ 2.1	May	−13.1	May	+20.7	Q1	126.6	Jun
India	+ 9.3	Q1	+10.0	May	+ 6.3	May	−41.0	May	−10.6	Q1	156.0	Jun
Indonesia	+ 4.6	Q1	− 3.6	Apr	+15.5	Jun	+32.7	May	+ 3.0	Q4	40.8	Apr
Malaysia	+ 5.3	Q1	+ 5.5	May	+ 3.9	May	+26.9	May	+19.5	Q1	79.0	May
Pakistan	+ 6.6	2006†	+19.3	Sep	+ 7.7	Jun	−11.2	May	− 4.8	Q1	11.5	Apr
Philippines	+ 5.5	Q1	−13.9	Apr	+ 6.7	Jun	− 3.6	Apr	+ 2.9	Mar	18.2	Jun
Singapore	+ 7.5	Q2	+10.6	May	+ 1.1	May	+32.7	May	+36.1	Q1	128.7	Jun
South Korea	+ 6.1	Q1	+11.6	May	+ 2.6	Jun	+18.2	Jun	+ 8.9	May	224.7	May
Taiwan	+ 4.9	Q1	+ 8.6	May	+ 1.7	Jun	+10.7	Jun	+18.1	Q1	260.4	Jun
Thailand	+ 6.0	Q1	+ 8.9	May	+ 5.9	Jun	− 3.7	May	+ 1.2	May	56.0	May
Argentina	+ 8.6	Q1	+ 6.0	May	+11.0	Jun	+11.6	May	+ 6.7	Q1	21.2	Apr
Brazil	+ 3.4	Q1	+ 4.8	May	+ 4.0	Jun	+44.7	Jun	+12.7	May	63.4	May
Chile	+ 5.1	Q1	+ 6.9	May	+ 3.9	Jun	+15.0	Jun	+ 0.8	Q1	17.4	May
Colombia	+ 5.2	Q1	− 1.8	Apr	+ 3.9	Jun	+ 1.1	Apr	− 2.0	Q1	14.5	May
Mexico	+ 5.5	Q1	− 0.8	Apr	+ 3.2	Jun	− 3.8	May	− 1.2	Q1	78.4	Apr
Peru	+ 3.6	Apr	− 1.5	Apr	+ 1.8	Jun	+ 6.0	May	+ 0.7	Q1	13.3	Apr
Venezuela	+ 9.4	Q1	+21.0	Mar	+11.8	Jun	+34.8	Q1	+28.1	Q1	23.7	Apr
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 6.4	Jun	−11.2	Q1	+ 2.1	Q1	22.1	May
Israel	+ 5.2	Q1	+ 2.7	Apr	+ 3.5	May	− 8.0	Jun	+ 4.4	Q1	27.5	Jun
Saudi Arabia	+ 6.5	2005‡	na		+ 2.4	Apr	+134.3	2005	+90.7	2005	24.0	Apr
South Africa	+ 4.0	Q1	+ 5.1	May	+ 3.9	May	− 6.1	May	−11.7	Q1	21.5	Jun
Czech Republic	+ 7.4	Q1	+12.2	May	+ 2.8	Jun	+ 1.5	May	− 3.4	Q1	30.4	Jun
Hungary	+ 4.6	Q1	+ 7.4	May	+ 2.8	Jun	− 3.1	Apr	− 7.9	Q1	21.8	May
Poland	+ 5.2	Q1	+19.1	May	+ 1.2	May	− 2.6	Apr	− 4.4	Apr	46.4	May
Russia	+ 5.5	Q1	+10.6	May	+ 9.1	Jun	+136.0	May	+93.5	Q1	243.2	Jun
Turkey	+ 6.4	Q1	+ 9.0	May	+10.1	Jun	−49.1	May	−28.7	May	59.6	May
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+11.6	Q1	+11.3	May	+ 4.3	Jun	− 2.7	Apr	− 1.5	Apr	2.2	Apr
Latvia	+13.5	Q1	+ 2.3	May	+ 6.3	Jun	− 3.3	Apr	− 2.1	Apr	2.6	Apr
Lithuania	+ 8.1	Q1	na		+ 3.7	Jun	− 3.9	May	− 1.8	Apr	4.0	Apr
Slovakia	+ 6.3	Q1	+11.4	May	+ 4.6	Jun	− 2.9	May	− 4.7	Mar	16.2	Apr
Slovenia	+ 5.1	Q1	+ 9.8	May	+ 2.9	Jun	− 1.7	May	− 0.3	Apr	8.3	Mar

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Jul 13th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 12th		Dec 30th 2005	
	Jul 12th	year ago	Jul 12th	% a year		one week	in local currency	in $ terms
China	7.99	8.28	14.6	2.80	1,829.4	+1.2	+ 49.8	+ 51.3
Hong Kong	7.78	7.78	14.2	4.38	16,522.2	+1.6	+ 11.1	+ 10.8
India	46.3	43.5	84.7	6.38	10,930.1	+0.1	+ 16.3	+ 13.2
Indonesia	9,110	9,793	16,691	12.97	1,345.9	+0.6	+ 15.8	+ 25.0
Malaysia	3.66	3.80	6.70	3.93	928.2	+0.4	+ 3.2	+ 6.7
Pakistan	60.2	59.7	110	9.02	9,920.7	-0.2	+ 3.8	+ 3.0
Philippines	52.2	56.2	95.6	7.88	2,231.7	-1.4	+ 6.5	+ 8.2
Singapore	1.59	1.69	2.90	3.53	2,422.8	-0.1	+ 3.2	+ 8.3
South Korea	949	1,038	1,738	4.60	1,296.7	+1.3	- 6.0	+ 0.2
Taiwan	32.5	31.9	59.5	1.79	6,634.1	-0.4	+ 1.3	+ 2.5
Thailand	37.9	41.9	69.5	5.40	686.0	+0.8	- 3.9	+ 3.9
Argentina	3.08	2.87	5.65	9.81	1,701.4	+0.1	+ 10.2	+ 8.3
Brazil	2.19	2.34	4.01	15.18	36,229.0	-0.4	+ 8.3	+ 15.5
Chile	540	581	989	5.04	9,835.2	-0.7	+ 6.8	+ 1.4
Colombia	2,511	2,327	4,601	6.17	8,404.6	+5.8	- 11.7	- 19.6
Mexico	11.0	10.7	20.2	7.04	19,419.4	-0.5	+ 9.1	+ 5.2
Peru	3.24	3.25	5.93	4.45	8,806.3	+4.1	+ 83.4	+ 94.3
Venezuela	2,646§	2,636§	4,847	10.15	31,237.4	+0.9	+ 53.2	+ 49.7
Egypt	5.75	5.78	10.53	8.86	47,166.7	+0.2	- 14.8	- 14.9
Israel	4.44	4.54	8.14	5.35	796.2	- 3.3	- 3.8	- 0.4
Saudi Arabia	3.75	3.75	6.87	5.33	11,868.4	- 9.1	- 29.0	- 29.0
South Africa	7.13	6.67	13.1	7.60	21,591.7	+3.1	+ 19.3	+ 6.2
Czech Republic	22.5	25.0	41.1	2.26	1,378.8	+0.2	- 6.4	+ 2.6
Hungary	218	204	400	6.76	22,341.0	+3.3	+ 7.5	+ 5.3
Poland	3.19	3.43	5.84	4.21	43,549.1	+6.7	+ 22.3	+ 25.1
Russia	26.9	28.6	49.4	11.50	1,552.4‡	+3.4	+ 29.3	+ 37.9
Turkey	1.56	1.33	2.85	21.09	35,815.5	+1.2	- 10.0	- 21.8
EM (MSCI)*	1.00	1.00	1.83	na	752.7	+0.9	+ 6.5	+ 6.5
EMBI+†	1.00	1.00	1.83	na	371.1	+1.4	+ 0.7	+ 0.7

* Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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